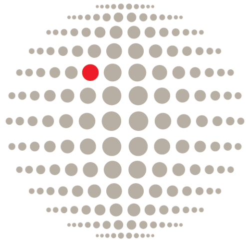

Partnership for New York City

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New York City and Terrorism Insurance in a Post-9/11 World

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The primary purpose of this report, which was prepared by the Research and Policy Department of the Partnership for New York City, is to educate the general public and is not intended to be partisan or used for specific lobbying activities.

Executive Summary

In November 2002, 14 months after 9/11, Congress and the White House created an insurance backstop program called the Terrorism Risk Insurance Act (TRIA). Since then, TRIA has served the insurance industry as a federal backstop for the payment of claims for certified acts of foreign terrorism in which the damages exceed $5 million.

Unless Congress and the White House extend TRIA or replace it with another program, TRIA will expire on December 31, 2005. Policy makers have a number of options that will ensure that businesses have access to adequate coverage at premiums businesses can afford. Washington could:

- Extend TRIA for two years, as Congress has proposed, or indefinitely, positioning the federal government as the permanent terrorism-insurance backstop;
- Allow TRIA to expire and permit the private market to establish the amount of insurance available and the price at which the insurance is offered;
- Promote the creation of a mutual insurance program to enable private insurers to pool and share risk stemming from terrorist attacks;
- Approve legislation to mandate a level of terrorism insurance for all private firms; and
- In tandem with resolving TRIA, reform the aid allocation formulas used by the Department of Homeland Security, which currently do not provide sufficient funds for high-risk areas, a policy that in part leads to higher terrorism insurance rates for businesses in those areas.

One option, or a combination of these options, may work effectively. With input from members of the insurance industry, the federal government should act early and expeditiously to reach a consensus on the most workable option, set of options or a temporary extension of TRIA if the parties are unable to reach a consensus. Without action on a new approach or an extension of TRIA, businesses in high-risk areas like New York will face reduced access to coverage and higher terrorism insurance premiums for the coverage they do obtain. Inaction in Washington will create a drag on economic growth in New York and other large cities.

Of all the cities in the United States, New York has the greatest exposure to insured losses from a terrorist attack, primarily for three reasons:

- New York City has the largest concentration of symbolic and economic targets. New York City has 67 buildings with 50 or more floors, almost twice as many as the next city, Chicago, and more than the next six cities combined.

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- Terrorist attacks that occur in dense urban environments will result in vastly higher losses than similar attacks in less dense cities, the suburbs and rural areas. New York City is by far the densest city in America with over 26,000 people per square mile, more than double the number of people per square mile in Chicago and Boston.
- Not only has New York City already survived two foreign terrorist attacks (1993 and 2001 World Trade Center attacks) but the two events rank among the world's top ten largest insured losses from terrorism.

According to the risk modeling firm Risk Management Solutions, Inc. (RMS), in 2004, approximately 50 percent of the nation's potential average annual insured loss due to terrorism is concentrated in New York City. The city with the second highest share, Chicago, has about 15 percent of the country's potential average annual loss while San Francisco follows with 8 percent and Washington, D.C., 5 percent.

Introduction

In this post-9/11 world, the insurance industry and the federal government continue to be crucial players in ensuring the economic vitality of New York City and other cities across the country. In November 2001, the Partnership for New York City released an economic impact study, which estimated that the 9/11 attack caused a loss of at least $83 billion in gross economic output. Even after payment of insurance claims of about $47 billion and the federal government's pledge of about $20 billion for rescue, cleanup and infrastructure repair costs, the net damage to the city's economy was at least $16 billion (Partnership for New York City, 2001).

Businesses across the spectrum are dependent on the insurance sector and the federal government as the primary entities for managing terrorism risk. This service is essential to conducting daily operations and providing an environment for innovation and activity that keeps the city and the country performing as the global economic engine. Without access to adequate insurance at premiums businesses can afford, companies would have second thoughts about locating or expanding in a place with higher insurance costs and larger exposure to financial risk.

In the months before 9/11, the value of many nationwide insurers' investment portfolios declined due to several factors, including declines in the stock market, the economic recession and large payouts for major natural disasters in recent years. This so-called "hard market" developed after a prolonged "soft market"[1] during which the value of insurers' investments in the markets soared (New York City Comptroller, 2002; Scanlon, 2004; The Council of Insurance Agents and Brokers (CIAB), 3Q2001).

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[1] "Soft market" means that many companies are writing insurance (strong capacity and competition), and premiums are low because of reduced losses and/or a strong return on investment. "Hard market" means that fewer companies are writing insurance or are providing less capacity (weak capacity and competition), and premiums are high because of greater losses and/or weak return on investment.

The 9/11 attack was another blow to an already struggling insurance industry. For the first time, annual net income for the U.S. property and casualty insurance industry fell below zero, a loss of $7.9 billion in 2001 (Hartwig, 2002a). Reinsurers, companies that assume a part of a risk policy from another insurer, had to absorb the insurers' losses and began excluding acts of terrorism from their policies. In turn, primary insurers also excluded acts of terrorism from policies, leaving many businesses in high-risk areas to face the risk of terrorism with no coverage, inadequate coverage or coverage that could only be obtained at higher prices.

The federal government stepped in to deal with this market failure. Fourteen months after 9/11, Congress approved and the President signed into law the Terrorism Risk Insurance Act of 2002 (TRIA). TRIA provides a $100 billion reinsurance backstop to insurers for acts of foreign terrorism as defined in the legislation and deemed to be "certified" as exceeding $5 million; TRIA covers 90 percent of all losses after the insurer meets its deductible. For the most part, this law has made it possible for business to have options for terrorism insurance coverage, and those options are more competitively priced than they were immediately prior to TRIA's enactment.

TRIA expires on December 31, 2005. Long before TRIA expires, Washington and the private sector need to reach consensus on an option or combination of options that will ensure that businesses have access to adequate coverage at premiums businesses can afford. High on the list of options are the following:

- Extend TRIA for two years, as Congress has proposed, or indefinitely, positioning the federal government as the permanent terrorism-insurance backstop;
- Allow TRIA to expire and permit the private market to establish the amount of insurance available and the price at which the insurance is offered;
- Promote the creation of a mutual insurance program to enable private insurers to pool and share risk stemming from terrorist attacks;
- Approve legislation to mandate a level of terrorism insurance for all private firms; and
- In tandem with resolving TRIA, reform the aid allocation formulas for programs in the Department of Homeland Security, which currently do not provide sufficient funds for high-risk areas, a policy that in part leads to higher terrorism insurance rates for businesses in those areas.

Perhaps none of these options will work alone. Washington and the private sector need to use the closing months of 2004 and early months of 2005 to reach consensus on an option or a combination of options. If the parties are unable to settle on a preferred option or options, they ought to agree on an extension of TRIA. Federal approval for a new approach or an extension of TRIA beyond its Dec. 31, 2005 expiration is the best way to create a climate that is reasonable and affordable for businesses in large cities like New York.

Evidence of the Insurance Effects of 9/11 on New York City

Immediately following 9/11, the exclusion of insurance for acts of foreign terrorism left businesses exposed to large amounts of financial risk. Some businesses were unable to buy insurance and some could not conduct all of their business activities (Saxton, 2002).

Ratings agencies lowered debt ratings for projects that were unable to obtain terrorism insurance. In turn, many banks would not finance construction projects or real estate transactions in the absence of terrorism insurance.[2]

Moody's Investors Service, for example, cut the AAA-ratings on 11 separate issues of commercial mortgage-backed securities valued at $4.5 billion. The trigger for the downgrades was the inability of the owners of the underlying properties to obtain full terrorism insurance coverage. Asset-backed securities deals offer greater security than most loans so the downgrades increased market anxiety. The commercial assets that were downgraded included 280 Park Avenue, 1211 Avenue of the Americas, 1251 Avenue of the Americas and Four Times Square Trust (Cohen, 2002).

In another case, the Empire State Building carried more than $600 million of property and liability insurance prior to 9/11 with an annual premium of approximately $1 million. After the attacks, the Empire State Building obtained substantially less coverage for property and liability for a premium of $9 million—nine times the premium prior to 9/11 (Malkin, 2004).[3]

Major entities in the public sector also experienced great difficulties obtaining the breadth of coverage they sought at premiums they considered reasonable. In 2001, the Metropolitan Transportation Authority paid $6 million for a $1.5 billion property and casualty policy that included terrorism coverage. In 2002, the MTA paid $18 million for a $500 million policy that excluded terrorism losses. A separate terrorism policy was obtained but it only provided $70 million in coverage at a cost of $7.5 million (Saxton, 2002).

In 2002, the New York City Comptroller conducted a survey of insurance agents and brokers serving businesses located throughout New York City. The City Comptroller's report discussed rate increases and availability for nine lines of property and casualty coverage in the year before 9/11 and the year following the attack (New York City Comptroller, 2002). The survey found that premiums for business of all sizes increased dramatically following 9/11. For large accounts (more than $1 million in premiums), the average premium increase jumped from 11.4 percent to 73.3 percent. Hartwig (2002b) shows that premium increases for accounts across the country rose by 20 percent in 2002, about half of which was related to the terrorist attack. Hence, premium increases in New York City significantly outpaced those in the rest of the nation.

The City Comptroller's survey also found a decline in insurance availability. Survey respondents were asked to rate insurance availability. According to the survey, for companies paying more than $1 million in premiums in New York City, access to 'readily available' and 'somewhat available' insurance fell from 84.1 percent to 20.2 percent.

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[2] This is the missing counterfactual that can not be quantified—projects that were slated to begin but were not undertaken because of prohibitively high insurance costs.
[3] This total includes terrorism coverage.

Terrorism Risk Insurance Act

With businesses in large urban areas facing soaring premiums and shrinking coverage options for terrorism, Congress sought to provide relief to insurers by passing the Terrorism Risk Insurance Act of 2002 (TRIA). In cases of foreign terrorism with certified damages that exceed $5 million, TRIA provides an insurance backstop to insurers and covers 90 percent of all losses after the insurer meets its deductible. These deductibles are based on percentages of earned premium income and increase annually from 7 percent in 2003 to 10 percent in 2004 to 15 percent in 2005. In its present form, the law sets an aggregate cap for liability at $100 billion for the government—total insured losses from 9/11 are estimated at around $47 billion (Partnership for New York City, 2001).[4,5]

On June 18, 2004, the Treasury Secretary extended the "make available" provision of TRIA for an additional year.[6] The Secretary was not required to make a determination until September 2004 and his early decision indicated that ruling in advance of the provision's expiration may help avoid market disruption (U.S. Treasury, 2004). Such disruption could occur because policy renewal decisions do not wait for government rulings. Business borrowing, expansion and development plans are in part a function of a firm's ability to purchase insurance and thus early government decisions help maintain a stable business climate.

Unless it is renewed, TRIA will expire on Dec. 31, 2005. The law, which was considered an interim solution for managing terrorism risk, assumed that the private insurance market for terrorism risk coverage would stabilize between 2002 and 2005. To date, the private insurance sector has not developed robust alternatives to TRIA for managing terrorism risk, due to a limited reinsurance market and the challenges the industry faces in modeling the frequency, complexity and severity of terrorist attacks. The government's early decision to extend the "make available" provision is an encouraging sign for proponents of TRIA and those who do not want coverage to dry up or become unaffordable.

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[4] Estimates of total insured losses from 9/11 range from a low of $25 billion (Moody's, 2002) to a high of $70 billion (Woodward, 2002). Most say the total losses are between $40 billion and $50 billion (Partnership for New York City, 2001; Marsh, 2004; Hartwig, 2002a; Saxton, 2002; Hillman, 2002) although more recent estimates put the figure at between $30 billion and $35 billion (U.S. Senate, 2004).

[5] Insurers are only liable for coverage under TRIA if the Secretary of the Treasury, the Secretary of State and the Attorney General of the United States certify an event as a terrorist attack. To be certified under the terms of this law, the terrorist attack must cause aggregate damages of more than $5 million. TRIA only covers a terrorist attack by "any foreign person or foreign interest"; hence, a domestic attack—for example, the Oklahoma City bombing in 1995—would not be covered under TRIA.

[6] The "make available" provision requires qualified insurers to make coverage for insured losses available in all property and casualty insurance policies and that coverage must not differ materially from the coverage applicable to losses from events other than acts of terrorism.

Risk Profile of New York City

New York City faces a higher risk for insured losses than other American cities for several reasons. First, Manhattan has the largest concentration of symbolic and economic targets, including high-profile buildings, buildings that house U.S.-based global corporations, Wall Street, tourist attractions and transportation hubs, all of which are appealing targets to terrorists. New York City has 67 buildings with 50 or more floors, almost twice as many as the next city, Chicago, and more than the next six cities combined.

Buildings Over 50 Stories in the U.S.	
City	**Number of Buildings with 50+ Floors**
New York	67
Chicago	39
Houston	11
Los Angeles	10
Dallas	10
Atlanta	8
Seattle	5
Philadelphia	5

Source: Saxton (2002).

Second, terrorist attacks that occur in dense urban environments will result in vastly higher losses than similar attacks in less dense cities, the suburbs and rural areas. In this respect, New York City dwarfs other cities across America. Data from the 2000 Census makes it possible to compute the population per square mile of every city and county in America. As the table below shows, New York City is by far the densest city in America with more than 26,000 people per square mile. New York County (Manhattan) drives this figure with a density of almost 67,000 people per square mile, four times as dense as all of San Francisco.

Density (population per square mile)			
City	**Population**	**Land (square miles)**	**Population per square mile**
New York City	8,008,278	303.3	26,403
San Francisco	776,733	46.7	16,634
Chicago	2,896,016	227.1	12,750
Boston	589,141	48.4	12,166
Philadelphia	1,517,550	135.1	11,234
Washington	572,059	61.4	9,316
Baltimore	651,154	80.8	8,058
Los Angeles	3,694,820	469.1	7,877
County			
New York County, NY	1,537,195	23.0	66,940
Kings County, NY	2,465,326	70.6	34,917
Bronx County, NY	1,332,650	42.0	31,709
Queens County, NY	2,229,379	109.2	20,409
Richmond County, NY	443,728	58.5	7,588

Source: Authors' calculations, 2000 Census.

Third, New York City has already been attacked twice and there have been several other foiled attempts in recent years. The two attacks rank among the world's top ten largest insured losses from terrorism. The 9/11 attack ranks as the costliest in the world at $47 billion in insured losses.

Largest Insured Loss from Terrorism, 1970-2001 (in millions of 2001 dollars)			
Event	**Country**	**Victims**	**Insured Loss**
Attack on the World Trade Center (2001)	USA	2,823*	$47,000
Bombing in the City of London (1993)	UK	1	$907
Bombing in Manchester (1996)	UK	0	$744
First World Trade Center bombing (1993)	USA	6	$725
Bomb explodes in London's financial district (1992)	UK	3	$671
Suicide bombing in Colombo Airport (2001)	Sri Lanka	20	$398
Bombing at London's South Key Docklands (1996)	UK	2	$259
Oklahoma City bombing (1995)	USA	166	$145
PanAm Boeing 747 explosion at Lockerbie (1988)	UK	270	$138
Three hijacked airplanes dynamited in Zerga (1970)	Jordan	0	$127

Source: Hartwig (2002a), Partnership for New York City (2001), and Saxton (2002).
*Estimate as of May 2002.

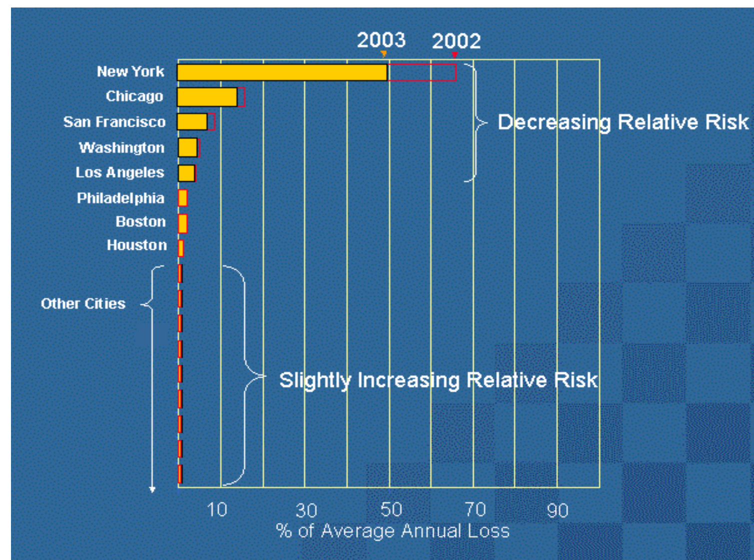
Potential Insured Losses for New York City Compared to Other U.S. Cities

After 9/11, major risk modeling firms quickly developed probabilistic terrorism insurance models based on their catastrophe modeling of natural hazards such as earthquakes and hurricanes. These terrorism risk models rely on broad assumptions of targets and potential attacks. Unlike the natural catastrophe market where a substantial history exists to help determine trends, terrorist attacks are significantly less predictable and have been less frequent.

These probabilistic terrorism insurance models are designed to enable insurers to price and manage accumulated exposures to terrorism losses from various attacks, which risk modeling firms simulate. These models attempt to provide loss probability distributions, expected annual loss and scenarios for probable payouts to cover workers' compensation and property losses. There are two main parts to calculating loss distributions from potential attacks. First, the models determine the type of terrorist attack, including a variety of conventional and non-conventional attacks with various types of weapons. Second, a list of likely terrorist targets is assembled relying on the data and expertise of military and intelligence agencies.

Based on analysis from the risk modeling firm RMS,[7] approximately 50 percent of the nation's potential average annual insured loss due to terrorism is concentrated in New York City. This is mainly due to the city's density and large number of high-profile targets. While many large cities saw a slight increase in potential average annual insured loss from 2002 to 2003, New York City's share decreased from about 65 percent to 50 percent. This decrease stems mainly from international efforts to curb terrorism and domestic efforts—both nationally and locally—to reduce the probability of another attack. In 2004, RMS models show that New York City's share remains at about 50 percent. The city with the second highest share, Chicago, has about 15 percent of the country's potential average annual loss while San Francisco follows with 8 percent and Washington, D.C., 5 percent.

Potential Average Annual Insured Loss for Major US Cities, 2002-2003



Source: Risk Management Solutions, Inc.

[7] These numbers, produced by RMS, are based on a model that quantifies the impact of 78,000 potential terrorist events that range from conventional weapons to chemical, biological, radiological, and nuclear weapons. The model bases the potential average annual loss figures for exposed values (human life, property, and interruption of business activity) on several factors, including the amount of insured loss, probability of attack, and frequency of attack. These events are modeled at potential terrorist targets across the United States and include potential property, workers' compensation, and direct business interruption losses.

Relative Risk for Major Urban Counties

The risk modeling firm AIR Worldwide Corporation[8] calculated the relative risk (in terms of potential average annual insured loss with Washington, D.C. normalized to 1) from terrorist attacks at the county level and found that the potential average annual insured loss in Manhattan is 13 times greater than in Washington, D.C.,[9] four times greater than Los Angeles, and three times greater than Chicago. When all five boroughs (counties) of New York City are analyzed, New York's relative risk in terms of potential average annual insured losses rises to 14.20. This elevated level of risk for the entire city reflects the manner in which a terrorist attack on Manhattan would affect the city's four other boroughs.

Relative Risk In Terms Of Average Annual Insured Losses for Major US Counties	
County	**Relative Risk**
New York County (Manhattan)	13.02
Cook County (Chicago)	4.12
Los Angeles County (LA)	3.01
San Francisco County (SF)	1.24
Washington, D.C.	1.00
Harris County (Houston)	0.65
Suffolk County (Boston)	0.41
King County (Seattle)	0.40
Philadelphia County (Philadelphia)	0.30
Dallas County (Dallas)	0.30

Source: AIR Worldwide Corporation (2003).

Options

In recent decades, the federal government has stepped in to provide insurance or financial support to industries that have been unable to obtain coverage from insurers in the private sector. The level of federal government involvement ranges from no government subsidies (Pension Benefit Guaranty Corporation Insurance[10]) to partial government subsidies (National Insurance Development Program[11]) to full government subsidies (Federal Crop Insurance and National Flood Insurance) (see GAO, 2001).

[8] The AIR analysis is based on possible attacks by both conventional weapons and weapons of mass destruction on more than 300,000 potential terrorist targets across the United States. The analysis considers both international and domestic terrorist threats and includes property, workers' compensation, and direct business interruption losses.

[9] Both models factor in only privately insured buildings and workers covered by workers' compensation. Government buildings, which are not privately insured, are not included in the analyses. While Washington, D.C., and New York City face a similar likelihood of attack, a large share of Washington's buildings are government-owned and hence not privately insured.

[10] Entity established by federal law in 1974 to insure retirement benefits of workers and beneficiaries covered by private sector-defined benefit pension plans. This agency is financed by premiums paid by employers on behalf of their employees.

[11] Insures against property losses due to riot and civil disorder. This program is financed by insurer premiums with a federal reinsurance mechanism.

Other nations, including Israel, Italy, Spain, France, Germany and South Africa, have national terrorism insurance and reinsurance programs that have varying degrees of government involvement (Hartwig, 2002a; Meder, 2004). With TRIA set to expire in December 2005, the federal government and private sector should figure out a solution long before the legislation expires to avoid uncertainty and creating a brake on business activity. Currently, some in Congress have raised the possibility of a two-year extension for TRIA (U.S. Senate, 2004). Yet delayed action by the government would stymie business' ability to make insurance and other investment decisions, which in turn would be a drag on economic growth. To prevent either of these possibilities from becoming a reality, there are a number of options that the private sector and Washington ought to consider in the closing months of 2004 and in the first half of 2005.

Option #1—Extend TRIA

The federal government serves as the insurer of last resort in several programs including Federal Crop Insurance, National Flood Insurance, and the Bank Insurance Fund. Making TRIA permanent would extend the federal government's role as an insurer of last resort and would seem to be logical in light of the national security implications of attacks by foreign terrorists.

Ensuring the stability of the national economy by providing financial support for uncertainties created by potential foreign terrorist attacks is a role that the federal government is best equipped to play. Damage created by terrorist attacks in one area of the country will have economic repercussions across the nation. Failure to address these uncertainties would surely create another drag on business activity and for that reason, there is legislation pending in Congress that would extend TRIA for two more years.

However, government-provided terrorism insurance may result in inefficiencies, distortions and crowding-out before it becomes clear whether a private sector solution may be possible, especially if the probability of terrorist attacks declines. Under the current TRIA legislation, there are also several revisions that could be made. The federal government is responsible for losses up to a maximum of $100 billion per (policy) year, January 1 to December 31; this may be too heavy a financial burden for the government. Other possible areas for modification include limiting the public's obligation to cover the damage caused by a major act of foreign terrorism that involves weapons of mass destruction (such as chemical, biological and nuclear weapons) or further limiting the government's role both in regulation and financial liability (Hunter, 2004).

Option #2—Allow TRIA to expire

When TRIA was originally passed in November 2002, Congress intended to "establish a temporary Federal program" that would "allow for a transitional period for the private markets to stabilize… ." (U.S. Congress, 2002). However, bills, which contain two-year extensions, have now been introduced in both the House and Senate. Congress had hoped that by the time TRIA expired the insurance industry would be able to assess the risk of terrorism and have the capacity to absorb future losses. The market does seem to be settling somewhat as prices have fallen slightly through late 2003 and early 2004 (Marsh, 2004; CIAB, various years) but much uncertainty remains. Given these trends, an option available to Congress is to allow TRIA to expire, although without another alternative,

this option would be detrimental to New York City and other cities with major central business districts.

From the public's perspective, perhaps, the federal government should not play the role of insurer to the nation's businesses (Gron and Sykes, 2002; O'Neill, 2001; McCool, 2001) and bail out the insurance industry. Some consumer groups argue that the insurance industry has the financial capacity to insure acts of terrorism. In addition, due to its high deductible and aggregate cap, TRIA may not be of particular value to the insurance industry. And while businesses in New York City and other large cities are facing the brunt of higher costs due to terrorism, the remainder of the country is not affected as much by the terrorism insurance issues.

However, in the absence of government intervention, the terrorism insurance market may never feature actuarially fair prices and high participation because of the inherent unpredictability of the terrorist risk. Moreover, while the expiration of TRIA may not affect some parts of the country, New York City and other large cities could be seriously damaged. The financial repercussions of instability and disruptions in these central business districts would weaken the rest of the country.

Option #3—Create a privately-run insurance pool

Insurance companies in some countries have formed privately-run pools to spread the risk of losses due to terrorism. A series of terrorist attacks in Great Britain in 1992 and 1993 led to government intervention after insurers quit offering terrorism coverage. In 1993, the Pool Reinsurance Company Ltd. ("Pool Re") was formed, a mutual insurance company funded by private insurers with the British government acting as the reinsurer of last resort (Astre, 2004; Barnes, 2004). Pool Re was modeled after the South Africa Special Risks Insurance Association, which was created after the Soweto riots of 1976. In both nations, premiums received by the pool have outpaced claims paid out and the national governments have not had to expend any funds. In January 2002, France also established a government backed terrorism pool similar to the one in Great Britain.

Before the passage of TRIA in November 2002, the U.S. insurance industry proposed a similar organization, called the "Insurance Stabilization and Availability Act of 2001."[12] Some in Congress opposed this proposal because it would introduce a federal role in an industry regulated by the states. Others were concerned that the government would be left administering the program while others criticized various other elements of the proposal, including the apparent override of antitrust laws and changes in tort rules. It also allowed individual companies to opt in or out of the program (Hunter, 2001; McCool, 2001; and Sebelius, 2001).

Going forward, a privately maintained insurance pool may be a way for the insurance industry to pool both funds and risk in order to keep premiums down and the number of insured businesses up. Two of the many reasons why terrorism insurance premiums are so high is (1) insurers have not yet been able to confidently assess the terrorist risk, and

[12] The proposal was also similar to the Homeowners Availability Act (H.R. 21), which set up a reinsurance pool relating to natural disasters.

(2) the potential liability is high. A pooled insurance fund would enable insurers to create a singular methodology to assess terrorism risk *and* to share the risk across firms.

Option #4—Mandate a level of terrorism insurance and reinsurance

The federal government could mandate a level of terrorism insurance and reinsurance for all commercial property owners and businesses with a certain number of employees.[13] If insurance coverage were made mandatory, insurers would be better able to spread the risk, lower costs to businesses across the country and provide more insurance. However, this begs the question of whether it is fair to require businesses that have almost no risk of attack to incur this additional cost even though the threat of terrorism affects the entire country regardless of individual location. In addition, mandating the purchase of terrorism insurance does not necessarily mean that it is being provided in high-risk areas, an issue of major concern in this brief.

Mandatory terrorism insurance would be similar to mandatory car insurance. Car insurance is mandated since individual accidents by their nature are difficult to predict. The car insurance mandate spreads the risk of accidents across the entire pool of drivers, lowering the cost of insurance and making it available for most people. Mandating terrorism insurance would have similar effects. Because terrorist attack locations are difficult to predict and commercial property owners are located near many of the nation's important assets, mandating terrorism insurance would serve to pool the risk and lower premiums.

Option #5—Reform Homeland Security funding for high-risk urban areas

The current system for allocating homeland security aid does not appropriately account for the needs of areas that face the greatest risk of attack. This in part has led to higher terrorism insurance costs in those areas.

Aside from installing blast structures on windows and doors, creating redundant security and safety systems, training building personnel to provide counter-terrorism services and developing other preventive initiatives, there are few steps that individual property owners can take to prevent a terrorist attack. Outside of moving operations away from high-threat areas, individual property owners are highly dependent upon the government to provide intelligence and law enforcement to prevent attacks and to provide the preparation and training to mitigate the effects of a future attack. There is a real distinction between preparing for a natural disaster like a hurricane and defending against a terrorist attack, which is significantly more random and much harder to predict.

In the case of natural disasters, for example, the federal government through FEMA has played a significant role not only in alleviating the financial burden of major disasters, but also in mitigating the financial burden of future disasters. To deal with terrorism, the federal government established the Department of Homeland Security and funded a variety of programs to prepare for future attacks. However, the current funding system is flawed. An April 2004 report released by Rep. Christopher Cox, Chairman of the House

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[13] Insurance and reinsurance companies would be required to offer terrorism insurance akin to TRIA's "make available" provision.

Select Committee on Homeland Security, found that "DHS awarded homeland security grant funds to States…without any real assessment of need or risk (except for the Urban Area Security Initiative)." The report also found that "there were no Federal terrorism preparedness standards or goals to guide expenditure of funds at the state and local levels, leading to numerous examples of questionable spending" (U.S. House of Representatives, 2004).

In some cases, steps can be taken by policy holders to manage risk and, as a result, insurance premiums may be lower. In the case of terrorism insurance, insured businesses are highly dependent on the government to take actions to prevent and plan for terrorist attacks. The current federal funding formulas are largely based on population. The federal government should consider homeland security funding formulas based on need and risk and isolate the determination of eligibility from politics as usual.

Conclusion

Terrorism is a national security issue with costs—both one-time and recurring—that should be shared by the entire nation. Following the attack on 9/11, New York City internalized net costs of at least $16 billion, and city businesses faced increased operating costs due to added security and insurance burdens. The city also lost nearly $3 billion in tax revenue directly attributable to the attack and independent of the effects of the recession. Without a partnership between the federal government and the insurance industry, businesses in New York City and other large cities potentially face an even greater share of costs in the event of another terrorist attack on the country.

By 2005, Congress will have decided whether to extend TRIA. The options discussed in this issue brief are by no means mutually exclusive or a definitive list. For example, reforming homeland security funding formulas to ensure that our country's central business districts receive adequate funding can and should work in tandem with extending TRIA or creating a privately-operated terrorism reinsurance pool. Regardless of the localized nature of the terrorist targets, it is in the national interest to ensure that businesses in our country's leading central business districts have access to affordable and extensive coverage at a price that is good for the nation's economy. Congress and the President have limited means to influence the macro economy. However, by addressing the terrorism insurance needs of businesses, Washington will help the private sector control costs and eventually spur further economic growth. For the sake of business continuity and to foster a hospitable economic environment, Congress should make a decision about adequate access to terrorism insurance no later than the first half of 2005--long before TRIA's December 31, 2005 expiration.

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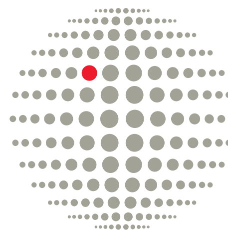
The Partnership for New York City (www.partnershipfornyc.org) is a network of business leaders dedicated to enhancing the economy of the five boroughs of New York City and maintaining the city's position as the global center of commerce, culture and innovation.



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