



Robert Detlefsen, NAMIC's vice president of public policy, moderates a panel discussion about the future of the Terrorism Risk Insurance Act at the 2012 NAMIC Public Policy Summit with (from left to right) Mark Calabria, Cato Institute, Tracey Laws, Reinsurance Association of America, and Erwann Michel-Kerjan, the Wharton School.



The discussion is available to view on NAMIC.org at www.namic.org/video/12pubpol.asp

The Case Against TRIA

By Mark Calabria

Congress would best serve the public interest by allowing TRIA to expire.

Short of that, states and insurance companies should be allowed to opt out of having to provide terrorism risk insurance and having to participate in any recapture of taxpayer losses.

Insurance is fundamentally about the pooling and sharing of risk. It is not, however, the only vehicle for doing so. This is especially true in the commercial real estate market, the sector most impacted by TRIA. The most likely physical targets of TRIA will be public buildings or trophy commercial properties. In the case of public buildings, it would be cheaper for the public to directly backstop those properties rather than rely on insurance. In the case of private commercial properties, a real estate investment trust ownership structure provides a ready avenue for spreading the risk of losses that may result from terrorism. And, of course, most trophy commercial properties are owned by publicly traded corporations that by their very nature spread the risk to their shareholders. The existence of TRIA does little more than privilege some forms of risk-pooling over others. It should not be the role of government to favor one industry instead of another.

As importantly, TRIA does nothing to lower the costs of terrorism. It simply shifts the cost from property owners and insurance companies to the taxpayer. Given the fiscal mess our federal government is in, it should be abundantly clear that the private sector can far better manage this risk than

taxpayers could. At worst, TRIA may actually increase the costs of a terrorist attack. By making available underpriced insurance, property owners and developers have a reduced incentive to construct and rehabilitate structures to better withstand a terrorist attack. The Congressional Budget Office also found that the existence of TRIA appears "to dampen the inclination of firms to relocate their operations away from high-risk areas." These increased potential property losses, because of TRIA's perverse incentives, do not account for the increased potential for loss of life from encouraging individuals to remain working or living in high-risk areas.

It is occasionally posited that we need TRIA because terrorism risk is "special" in that it is often geographically concentrated, that it is rare and hence not subject to the law of large numbers, and that the costs can be "extreme." None of these arguments are particularly compelling, especially when compared to natural disasters. Despite the geographic concentration of hurricanes, few argue for the federal provision of homeowners' insurance. The continuation of federal flood insurance is really due more to the subsidies than to any inability to price or provide. Large-scale natural disasters are themselves not subject to the law of large numbers, suggesting such an argument has little merit. Venetian merchants were forming risk pools before the discovery of the probability theory. The argument that theory or data has to come before something can be priced is simply inconsistent with

the factual history of risk.

Natural disasters also illustrate the industry's ability to manage and absorb large losses. The losses from hurricanes Andrew and Katrina and the Northridge earthquake were all comparable to 9/11, so there is nothing particularly special about the level of terror damage. If anything, 9/11 did less to threaten the solvency of the insurance industry than did Andrew or Katrina. And, of course, it should not be the role of the federal government to guarantee the solvency of private companies, whether they are in the insurance industry, the auto industry, or investment banking.

The insurance industry's initial reaction to 9/11 was the correct one: have states allow for the exclusion of terrorism coverage in a manner similar to damages resulting from wars. The problem was that California, Florida, Georgia, New York, and Texas would not provide such exclusions. While I am generally reluctant to see preemption of state insurance laws, the creation of TRIA has dragged the federal government into this field. A simple fix would be to have the federal government now allow for an exclusion of terrorism coverage nationwide. These few states are significant enough to form their own voluntary risk pools. The intent here is not to eliminate geographic cross-subsidies – which should end – the intent is to have prices that better reflect the actual underlining risks. If we should have learned anything from the financial crisis, it is that the deliberate underpricing of risk will end badly. ☹