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Insurers Gauge Risks of Terrorism

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The Pentagon's idea to set up a futures market in terrorism, in which financial traders would bet on the likelihood of assassinations, truck bombings and the like around the world, was laughed out of existence last week. And for good reason.

Flawed on a number of fronts, this was a system that conceivably could have prompted terrorists to kill — and make a killing at the same time.

Yet as morally repugnant as the Pentagon plan was, the notion of calculating the risk of terrorism in cold financial terms isn't actually all that kooky. In fact, it's being practiced increasingly by some of the most staid companies in the world: insurers.

They have taken the subject of terrorism "out of the emotional realm and put it into the analytic," says Janet Jones, head of **Elkins/Jones**, a Santa Monica insurance brokerage for commercial real estate.

Applied Insurance Research of Boston, a private company that devises risk models for natural disasters, has examined terrorist incidents around the globe to create what it calls a "probabilistic terrorism model capable of quantifying the risk from this emerging threat."

Translation: "We looked at the kind of targets" attacked by Al Qaeda and other groups, including the Irish Republican Army in Britain and Hezbollah in the Middle East, explains Jack Seaquist, who led development of AIR's new software program that assesses terrorism risk. "Were they corporate or governmental?"

What's more, Seaquist says, AIR queried experts in counterterrorism "about the groups' patterns of behavior."

Armed with such information, insurance companies then can set premiums on policies that guard against terrorism-related losses. It has been a growing business, not surprisingly, since the felling of the

World Trade Center in 2001.

Under the Terrorism Risk Insurance Act, which Congress passed last November, the Treasury Department has mandated that insurance companies offer policies to cover the acts of madmen. Should the loss exceed a certain amount — a prescribed percentage of the insurer's total business — the federal government would help pick up the tab.

For real estate owners, the costs of coverage are significant but not prohibitive.

If you own a \$150-million skyscraper, say, in the middle of a big city, you're likely to pay \$10,000 a year for terrorism coverage (on top of the \$105,000 you pay on your conventional policy).

That's about half what it was before the government stepped in with its financial backstop, according to Gary Marchitello, the managing director of national property coverage for Aon Corp.

But it isn't only that the price of policies has gone down. The insurance industry's level of sophistication has gone up — an important trend in helping guarantee the smooth functioning of the American economy.

Because of the advances made in software and systems over the last two years, insurance executives say, actuaries can now gauge the potential damage of terrorist attacks much the way they predict damage from hurricanes, tornadoes and earthquakes.

Bermuda-based Axis Capital Holdings, a company set up shortly after Sept. 11 to offer insurance against terrorism, says it relies on knowledge of terrorist groups in Britain in estimating risks and setting premiums.

American International Group Inc., one of the largest insurers against terrorism in the world, with \$1.2 billion in coverage, has a different approach. It doesn't believe that studying the way terrorists operate overseas — with car bombs, for example — is very useful for writing

insurance in the U.S.

"Those groups are not going to attack targets in America" in the same manner that they mount attacks abroad, says Richard Thomas, a senior executive who sets underwriting policy for AIG.

Instead, AIG focuses on the targets terrorists might hit: "symbols of America," to use Thomas' phrase. "Al Qaeda hit the World Trade Center and the Pentagon," he says. "Think of others."

He also has his eye on targets that could hobble our economy. "I think of petrochemical complexes on the Gulf Coast," Thomas says. The key, he adds, is to understand the probable "severity of damage from an attack."

Terrorism is imposing new costs on U.S. society and our economy. But businesses are finding ways to make this scourge more measurable and affordable. Perhaps John Poindexter, who just lost his job at the Pentagon after the futures-market idea blew up in his face, might be able to find work in insurance.

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Correction
Terrorism insurance — AIR Worldwide Corp. is the correct name of the Boston-based risk modeling and technology firm identified as Applied Insurance Research in James Flanigan's column in Sunday's Business section.