The world's most dangerous insurance publication℠

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The Night Comes Falling from the Sky

Loss and Fear

Schiff's Insurance Observer expresses its sorrow and concern for our friends and subscribers who worked in the World Trade Center, and for everyone touched by this week's events.

Although the insured losses will come to tens of billions of dollars—and the uninsured losses will be even higher—the insurance industry and the financial system are not imperiled. Life will go on: rubble will be cleared, activity will resume in lower Manhattan, the stock market will reopen. Despite the shock, loss, and mourning, backup systems are being activated, new locations are being leased, and industry will continue with its mission of making money.

Life will not go on as before, however. "These acts of mass murder were intended to frighten our nation into chaos and retreat," said President Bush. The country is not in a state of chaos, but it has been plunged into a state of worry and heightened awareness. Our security, once largely taken for granted, will no longer be. New safety measures and regulations are being instituted at airports, and will be instituted at office buildings, public spaces, and, perhaps, apartment buildings. They will be costly and time consuming. And they won't be perfect.

"Your armed forces are ready," said Joint Chiefs chairman Henry Shelton. "We stand together to win this war against terrorism," said President Bush.

Terrorism isn't a conventional "war." Armed forces cannot easily prevent suicide bombers. A small number of people willing to die for their cause can wreak horrendous damage. There's no easy, effective remedy for extremists who not only don't fear death, but embrace it.

"Far from being senseless," wrote columnist George Will, "much terrorism is sensible in that it is 'cost-efficient.' Or, to borrow the language of the stock exchange, 'highly leveraged.' Even sporadic terrorism can necessitate the constant cost deployment of defense against it."

In a free and open society there's no way to prevent random terrorist attacks, although steps can be taken to reduce their likelihood. Enhanced security cannot be achieved without considerable expense and disruption to the people it's designed to protect. Most Americans are used to easy access to public places and to the absence of security checks and surveillance.

While everyone wants safety, its inconvenience will not be popular. The cost of instituting national loss-prevention and loss-control measures will be a surcharge on daily living.

The events of this week are likely to have a deleterious effect on our economy, which was already teetering on the verge of recession. So far, surprisingly strong consumer spending in the face of a slowdown has helped stave off recession. Unemployment rates have been rising, however, consumer confidence had already fallen to an 8½-year low, and consumers are indebted *and* heavily invested in stocks. It's hardly inconceivable that consumers may do what leveraged, overextended people have a tendency to do: panic. This might take the form cutting back on spending *and* selling stock once the market reopens. (Since stocks are valued at levels that are rich by historical standards—an indication of investors' collective belief that nothing can go wrong—some panic may actually be prudent).

Foreign markets declined sharply after the attacks on the World Trade Center and the Pentagon; in London, insurance stocks are down about 15%. Short-term Treasurys have soared—an indication of fear and, perhaps, of a recession.

The insurance industry is cyclical, but it's insulated from the vagaries of economic cycles because insurance is a necessity. *SNL Insurance Daily* quoted Steve Musser, property-casualty analyst at A. G. Edwards, on the effect the World Trade Center loss might have on the insurance industry: "The psychological impact will help [insurance companies] extend the cycle on the upside. As perverse as we are, you have to take a positive outlook to this…If people were nervous that the cycle may not go to the middle of 2002, that will change. We'll see it going through 2003." Even if Musser is correct, a one-year cycle extension will not come close to recouping the money lost from this week's events. Many large insurers are worth significantly less today than they were on Monday. Collectively, insurance companies are too well capitalized for their own good, even though some companies will find themselves in worse shape than they anticipated.

The total losses at the World Trade Center buildings will alter insurance buyers' perceptions of risk, much as the fire 21 years ago at the MGM Grand Hotel did. (Eighty-three people died in that fire, and the MGM Grand Hotel had only $30 million of liability insurance. After that became known there was a recognition by property owners that they needed much higher limits of liability, and there was a temporary shortage of capacity.)

At present, many buildings aren't insured for full value, the theory being that large, modern fireproof office and apartment buildings don't suffer total losses. That theory has been dispelled now, and insurance buyers may want, or need, insurance to full value. Conversely, underwriters have routinely offered blanket limits of insurance to large property owners without fully considering that there could be a total loss at one huge property.

As insurance buyers and insurance companies come to the realization that they are overexposed, it seems inevitable that rates for large properties will rise. A temporary unavailability of high limits would not be surprising.

As this is being written, much of lower Manhattan is without power and phone service. Many businesses aren't adequately covered for extra expense, business interruption, and contingent business interruption. Increased demand for these coverages will increase insurance companies' exposure in a given area, which should push rates somewhat higher.

Conversely, as a means of loss control, companies may become reluctant to concentrate their risk by placing too many employees in one giant office building, choosing instead to spread their risk over several locations.

This week's calamity is, at least until proven otherwise, an act of terrorism, not an act of war. No nation has declared war on the United States and, for that matter, the United States (which has a long history of overthrowing and destabilizing foreign governments and backing monarchs, dictators, and terrorists when doing so was considered to be in our self interest), has not declared war on any nation.

The economy will go through its cycles, markets will fluctuate, claims will be paid, and buildings will be rebuilt. Life has been changed—but people will adjust. It's what they do. ■

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