**LegCo Panel on Financial Affairs**

# Impact of the 11 September 2001 Terrorist Attacks on the Insurance Industry

## Purpose

This paper is to brief members of the impact of the terrorist attacks in the United States on 11 September 2001 on the insurance industry.

## Background

2. The terrorist attacks on the U.S. have resulted in unprecedented losses of human lives and massive destruction to buildings and properties. Insurance losses arising from this event encompass a wide spectrum of insurance business, including life, property damage, business interruption, employees' compensation, aviation and motor. Although the full extent of the ultimate insurance losses has yet to be quantified, the current estimate of such losses from various sources is in the region of US$30 billion to US$60 billion. It is expected that a substantial share of these losses will be borne not only by the US insurance industry but spread across the insurance industries worldwide through the operation of reinsurance.

## Possible Impact on Global Insurance Industry

3. In face of the largest single-event loss in history, the immediate impact on affected insurers is that they will have to undertake the challenging task of assessing the extent of such losses and to process claims which are expected to accumulate very quickly in the days ahead. The more far-reaching impact of

the tragic events on the global insurance industry can be analysed as follows -

*(a) Contraction in global insurance and reinsurance capacity*

As a result of the tragic events, insurers are now alerted to the magnitude of such risk of terrorism which they might not have calculated before, or if calculated, not to the current magnitude. Insurers will become more cautious in their underwriting of risks. Both primary companies and reinsurers may find their reinsurance/retrocession arrangements inadequate to cope with the future size of claims. Primary insurers may wish to seek greater reinsurance protection but reinsurers may instead wish to reduce their capacity on offer. Aviation, property and liability sectors will be more affected while other sectors will also face similar circumstances but subject to a lesser degree.

(b) *Hardening of Premium Rates*

Price for reinsurance protection will rise significantly and therefore the rise in price for direct insurance also. This is not simply a function of contraction in capacity. Other contributing factors include -

(i) the tragic events have introduced new types of risks and larger potential losses;

(ii) the amount of risk capital required to support insurance risks is greater than formerly understood; and

(iii) the need for insurance and reinsurance companies to re-build their reserves.

The price rise, which is expected to become more evident from the beginning of next year, will be felt more in the general insurance sector than the life insurance sector.

(c) *More Coverage Restriction*

Some insurers or reinsurers may find specific sectors to be of such high risk that they are not prepared to provide cover. These high-risk sectors may include property (especially for high-rise buildings), aviation, business interruption and marine business. Underwriting standards will tighten and catastrophe reinsurance can become too expensive to acquire. More coverage restrictions will be imposed, for example restriction on terrorist acts and requiring a higher retention.

(d) *Financial Strain on Certain Insurers*

Given the uncertainties surrounding the ultimate cost of the terrorist attacks and the collectability of reinsurance recoveries, some less well-capitalized insurers may not be able to weather the current storm.

**Impact on Hong Kong Insurance Industry**

4. Insurance business, particularly reinsurance business, is an international business. Because of this and together with Hong Kong being one of the

major insurance centres in Asia with over 200 insurance players from 25 countries, the Hong Kong insurance industry is not immuned from the effect of the tragic events. Immediately after the happening of the tragic events, the Insurance Authority ("IA") had taken active steps to assess their impact on the financial stability of the Hong Kong insurance industry. Based on the information available so far, the estimated losses accruing to the Hong Kong insurance industry amount to about $32 million. This represents about 0.17% of the total premiums for 2000. The amount is therefore insignificant and would not pose a threat to the financial stability of the insurance industry.

5. As part of the global insurance system, the Hong Kong insurance industry will face similar pressure for restriction of insurance coverage and increase of premium especially for those high-risk sectors. The insurers and reinsurers have not yet come to any decision. However, indications so far obtained show that restriction of insurance coverage intended by the insurance industry appears to apply only to acts of terrorism. As regards increase of premium, while the actual extent remains to be worked out, it is expected that a general increase will be seen commencing next year.

6. Insurance business is a risk-assessing and pricing business. A higher premium will be charged for a higher risk. The determination of insurance premium is a commercial decision by the insurer. The Administration does not intervene into such commercial decisions. We will continue to work with the insurance industry to uphold the systemic stability of the Hong Kong insurance industry in the interests of the insuring public.

Office of the Commissioner of Insurance
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