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DOCUMENT NO.	FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
001	Memorandum	Federal Role in the Market for Aviation Terrorism Insurance [4 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 05/20/2025 JLS] - To: NEC Principles - From: Carlos Bonilla	4	04/12/2002	

COLLECTION TITLE:
Counsel's Office, White House

SERIES:
Kavanaugh, Brett - Subject Files

FOLDER TITLE:
Airline Insurance

FRC ID:
9802

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).

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APRIL 12, 2002

TO: NEC PRINCIPALS

FROM: CARLOS BONILLA

RE: FEDERAL ROLE IN THE MARKET FOR AVIATION TERRORISM INSURANCE

Background

Aviation Insurance provides three primary types of insurance, under a variety of different circumstances:

1) Insurance for the loss of the airplane, referred to as hull insurance.
2) Insurance for losses suffered by the passengers on that plane.
3) Insurance for losses caused to other people and property.

Broadly speaking, we can define this insurance as being provided under three circumstances:

1) For losses incurred during normal peacetime operations.
2) For losses incurred in times of war.
3) For losses incurred from acts of terrorism.

The private insurance market currently functions well for all three perils during both peace and war. Moreover, during war it imposes important discipline on the carriers by virtue of the fact that the coverage is cancelable on short notice. This allows the insurance to be appropriately re-priced to reflect the higher risk and provides the carriers a limited window during which they can remove their vulnerable assets from the war zone.

The insurance market even operates quite efficiently when the threat is terrorism. Although terrorism can pose a worldwide threat, making it impossible to relocate assets to a safe haven, the market has shown that it can price the risk for hull and passenger losses as these are known risks – maximum loss is limited to the value of the plane and the number of passengers it carries times the average compensation paid those passengers. The problem arises in liability for third party losses from acts of terrorism. The most notable such example is the loss of life in the World Trade Center attack.

Staff recommends that any action we take acknowledge that the insurance market has shown itself well capable of providing coverage for all other perils in all other circumstances and should be allowed to operate as it historically has. Thus, the only open issue is how to deal with third party losses resulting from an act of terrorism.

The policy question before the Administration is what role, if any, the federal government should continue to play in the market for aviation insurance against terrorist events.

Current State of the Market

Prior to the attacks of 9/11, airlines were paying approximately 25 cents a passenger to secure $1.5 billion of insurance coverage against all perils, with War and Terrorism coverage comprising about 2 cents of that. The cost has since risen to $1.25 per passenger, with a limitation of $50 million in third party losses, with severe limitations on third party losses from acts of war and terrorism.

Immediately after the terrorist attacks of 9/11, private insurers invoked cancellation clauses in their policies, leaving airlines without coverage. The Air Transportation Safety and System Stabilization Act authorized the federal government to provide insurance coverage. The Act capped third party liability at $100 million, and the FAA agreed to provide coverage above the first $50 million of losses for a charge of $7.50 per takeoff, approximately 8 cents per passenger. While the liability cap expired on March 20, the Secretary of Transportation extended the FAA insurance element for 60 days.

A private insurance consortium, headed by AIG, has expressed strong interest in providing this insurance coverage to the airline industry. This would provide $1b in third party coverage. The price initially quoted was $1.85 per passenger in addition to the $1.25 currently being charged, although market pressures may, over time, serve to attenuate that price. This offer of coverage, like the coverage which was offered prior to 9/11, would be cancelable at the discretion of the insurer, possibly forcing us to again revisit this issue in the future should another event occur. It is likely that an expanded private presence in the market would reduce this cost. In the UK, AIG has agreed to provide such coverage for only 75 cents per passenger, although it has not made a general offer of insurance to all carriers at this price.

At the same time, the airline industry is considering creating a captive insurer referred to as Equitime. This would be a risk retention group that would provide insurance services to the industry. The airlines reportedly are unwilling to form this insurer without a Federal commitment to provide excess of loss coverage. DOT would not offer this reinsurance for more than one year at a time, but it is not clear that one year of federal reinsurance would suffice. Equitime is intended to provide coverage not just for the third party losses from terrorism but for all the industry's insurance needs.

Regardless of the manner in which insurance is provided, or the amount of coverage purchased, it seems clear that any large scale event will ultimately involve some level of federal assistance.

Recommendation From Principals

A consensus was reached at the first Principals meeting that the appropriate solution was to limit third party liability from acts of terrorism. This was accompanied by the recognition that only legislative action could achieve this goal and that such action was unlikely in the current session of Congress. This requires that decisions be made on how to meet insurance needs of the industry in the medium term.

Decisions Required by Principals

1) Should we seek legislative action in the next Congress to limit third party liability from acts of terrorism?

Discussion: This decision may be premature and it may be desirable to await the conclusion of congressional action on the broader terrorism insurance bill. Note that the coverage limits in the bill under discussion in the Congress cover all property and casualty losses (not just those for aviation) and call for private insurance coverage of the first $10 billion of an event and that this far exceeds the coverage the airlines formerly carried or feel they could afford to carry today. The final version of this bill, if it becomes law, may affect the decision to act on liability limitation.

2) On March 20th, The Department of Transportation extended for 60 days the third party liability insurance it offers through the FAA. Upon expiration of those 60 days should we:

- Exit market immediately and require the airlines obtain private coverage.
- Keep existing FAA program in place but gradually transition out of the market by raising premiums and/or increasing the "deductible."
- Keep existing FAA program in place "as is" while pursuing liability limitations.
- Subsidize the airline industry Equitime proposal through provision of excess of loss coverage. This will require legislation.

Discussion: This is the most difficult and contentious issue and the central area where we need guidance from Principals. To a great degree, one preferred solution depends heavily on how one resolves the philosophical differences that these options represent.

Immediate market exit: If the operating philosophy is that market forces are the appropriate solution then we should promptly announce our intention to exit the direct provision of insurance. In addition, we should make clear that we would not subsidize Equitime.

Phased Market Exit: If the goal is to ensure that insurance is available and one does not believe the private insurance market will or can properly price the product under current circumstances, then the case can be made for subsidizing private insurers (e.g., Equitime for the terrorism component only) or providing the insurance through the Federal Government and attempting to price it at the "appropriate" rate. This can be done by a combination of increases in the premium charged by the FAA or an increase in the deductible on that policy which would have to be covered through private markets.

Continue Federal Insurance "as is": The argument for this position is that American institution which are targeted as vehicles of terrorism should not be unduly forced to bear the costs of those act. Thus, under this view, the costs should be borne by society as a whole. That goal can be met by continuing to provide the insurance through the FAA and providing it a below market rates while we attempt to limit liability.

Subsidize Equitime: Staff has serious reservations about subsidizing the Equitime proposal. Not only does it require a federal subsidy with which it will compete against private parties; it will do so across a broad range of insurance products, not just third party liability from terrorist acts. The staff recommendation is that any Equitime subsidy be limited to third party liability and be conditioned on providing comparable reinsurance to all parties seeking to compete against Equitime.