

Need for the Regulation and Market Failure

This regulation implements the SAFETY Act and is intended to implement the provisions set forth in that Act. The Department believes the current development of anti-terrorism technologies has been slowed due to the potential liability risks associated with their development and eventual deployment. In a fully functioning insurance market, technology developers would be able to insure themselves against excessive liability risk; however, the terrorism risk insurance market appears to be in disequilibrium. The attacks of September 11 fundamentally changed the landscape of terrorism insurance. Congress, in the findings of TRIA, concluded that temporary financial assistance in the insurance market is needed to "allow for a transitional period for the private markets to stabilize, resume pricing of such insurance, and build capacity to absorb any future losses." TRIA § 101(b)(2). This interim rulemaking addresses a similar concern, to the extent that potential technology developers are unable to efficiently insure against large losses due to an ongoing reassessment of terrorism issues in insurance markets.

Even after a temporary insurance market adjustment, purely private terrorism risk insurance markets may exhibit negative externalities. Because the risk pool of any single insurer may not be large enough to efficiently spread and therefore insure against the risk of damages from a terrorist attack, and because the potential for excessive liability may render any terrorism insurance prohibitively expensive, society may suffer from less than optimal technological protection against terrorist attacks. The measures set forth in this interim rule are designed to meet this goal; they will provide certain liability protection from lawsuits and consequently will increase the likelihood that businesses will pursue important technologies that may not be pursued without this protection.

Costs and Benefits to Technology Development Firms

Since this interim rulemaking puts in place an additional voluntary option for technology developers, the expected direct net benefits to firms of this interim rulemaking will be positive; companies presumably will not choose to pursue the designation of "anti-terrorism technology" unless they believe it to be a profitable endeavor. The Department cannot predict with certainty the number of applicants for

this program. An additional source of uncertainty is the reaction of the insurance market to this designation. As mentioned above, insurance markets appear currently to be adjusting their strategy for terrorism risk, so little market information exists that would inform this estimate. The Department invites comments on these issues.

If a firm chooses to invest effort in pursuing SAFETY Act liability protection, the direct costs to that firm will be the time and money required to submit the required paperwork and other information to the Department. Only companies that choose to request this protection will incur costs. Please see the accompanying PRA analysis for an estimate of these costs.

The direct benefits to firms include lower potential losses from liability for terrorist attacks, and as a consequence a lower burden from liability insurance for this type of technology. In this assessment, we were careful to only consider benefits and costs specifically due to the implementation of the interim rule and not costs that would have been incurred by companies absent any interim rulemaking. The SAFETY Act requires the sellers of the technology to obtain liability insurance "of such types and in such amounts" certified by the Secretary. The entire cost of insurance is not a cost specifically imposed by the proposed rulemaking, as companies in the course of good business practice routinely purchase insurance absent Federal requirements to do so. Any difference in the amount or price of insurance purchased as a result of the SAFETY Act would be a cost or benefit of this interim rule for firms.

The wording of the SAFETY Act clearly states that sellers are not required to obtain liability insurance beyond the maximum amount of liability insurance reasonably available from private liability sources on the world market at prices and terms that will not unreasonably distort the sales price of the seller's anti-terrorism technologies. We tentatively conclude, however, that this interim rulemaking will impact both the prices and terms of liability insurance relative to the amount of insurance coverage absent the SAFETY Act. The probable effect of this interim rule is to lower the quantity of liability coverage needed in order for a firm to protect itself from terrorism liability risks, which would be considered a benefit of this interim rule to firms. This change will most likely be a shift back in demand that leads to a movement along the supply curve for technology firms already in this market; they probably will buy less liability

coverage. This will have the effect of lowering the price per unit of coverage in this market.

The Department also expects, however, that this interim rulemaking will lead to greater market entry, which will generate surplus for both technology firms and insurers. Again, this market is still in development, and the Department solicits comments on exactly how to predict the effect of this interim rulemaking on technology development.

Costs and Benefits to Insurers

The Department has little information on the future structure of the terrorism risk insurance market, and how this interim rulemaking will affect that structure. As stated above, this type of intervention could serve to lower the demand for insurance in the current market, thus the static effect on the profitability of insurers is negative. The benefits of the lower insurance burden to technology firms would be considered a cost to insurers; the static changes to insurance coverage would cause a transfer from insurers to technology firms. On the other hand, this type of intervention should serve to increase the surplus of insurers by making some types of insurance products possible that would have been prohibitive to customers or impossible for insurers to design in the absence of this interim rulemaking. The Department is interested in public comment on any possible negative or positive impacts to insurers caused by the SAFETY Act and this interim rulemaking, and whether these impacts would result in transfers within this market or an efficiency change not captured by another party. We encourage commenters to be as specific as possible.

Costs and Benefits to the Public

The benefits to the public of this interim rulemaking are very difficult to put in dollar value terms since its ultimate objective is the development of new technologies that will help prevent or limit the damage from terrorist attacks. It is not possible to even determine whether these technologies could help prevent large or small scale attacks, as the SAFETY Act applies to a vast range of technologies, including products, services, software, and other forms of intellectual property that could have a widespread impact. In qualitative terms, the SAFETY Act removes a great deal of the risk and uncertainty associated with product liability and in the process creates a powerful incentive that will help fuel the development of critically needed anti-terrorism