

# Terrorism Update

Willis

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The long-awaited passage of the Terrorism Risk Insurance Act (TRIA) in November 2002 provided welcome relief for many industry sectors whose ability to secure coverage for terrorism risks had been severely curtailed since September 11, 2001. However, questions persist on the application of various provisions under the mandatory protection offered under the Act, as well as limitations in the scope of coverage and the long range implications of the program.

As a result, the stand alone terrorism insurance market continues to be active, despite some suggestions to the contrary. This is due, in part, to inconsistent rate structures offered by insurers inexperienced in underwriting terrorism as an isolated peril, as well as the limited scope and lack of global reach of TRIA. "Policyholders are no longer only real estate operations with target properties that need to appease lenders," according to Jack Graham at AIG, the leading U.S. writer of stand alone terrorism insurance. "Today, numerous municipal entities, such as thruway and port authorities, airports and seaports are signing up [for stand alone insurance]." The global marketplace in particular has seen increased demands for those risks outside the scope of TRIA and other state-supported terrorism risk transfer schemes.



**Willis' Global Markets North American Property Team can advise, arrange and syndicate policies to protect organizations against many types of terrorism risks. We are market leaders in this specialty and are renowned for our creative solutions in handling these exposures.**

## TRIA Fundamentals

- Congress enacted the Terrorism Risk Insurance Act of 2002 in Nov. 2002. Unless renewed, it expires at the end of 2005.
- To qualify under TRIA, the event must be certified by the Secretary of the Treasury, Secretary of State and the Attorney General.

Certified acts are defined as:

- violent or dangerous to human life, property or infrastructure, and
  - perpetrated as part of an effort to coerce the civilian population of US or influence government policy or affect the conduct of US government, and
  - be committed by someone acting on behalf of a foreign person or interest;
- Loss cannot be incurred as part of the course of war declared by Congress.
  - Insurance companies must retain a deductible *and* 10% of their losses above that. The program caps out at \$100 billion.
  - Certain government contributions under TRIA will be recouped through premium surcharges in the years to follow.

## Contacts:

Wendy Peters ( U.S.)  
Direct Telephone: (1) 610-254-7288  
Email:  
wendy.peters@willis.com

Jon Hughes ( London )  
Direct Telephone: +44 (0) 20 7975  
2029  
Email:  
jon.hughes@willis.com

# Why Insure Against Terrorism

Terrorism remains a global reality. The recent war in Iraq, discord with Syria and North Korea all could provoke a violent response.

- Proximity to risk : who are your neighbors?
- Obligatory. Can be prerequisite to loan agreements.
- High severity potential but unpredictable.
- Severe business interruption potential.
- Terrorism stems from a variety of sources:
  - Extremists such as the KKK and Aryan Nation
  - Foreign terrorists such as Hezbollah, Al-Qaeda, Abu Nidal, IRA, Shining Path
  - Special interest groups such as environmentalists and animal rights, anti-abortion, human rights, anti-nuclear activists;



## Who is Buying Terrorism Insurance?

- International hotel chains
- Power generation facilities
- Financial institutions
- Oil and gas refineries
- Shopping centers
- Port authorities
- Convention centers
- Urban/suburban office complexes
- Stadiums
- Apartments/condominiums
- Entertainment complexes/casinos
- School districts
- Airports
- Water treatment facilities
- Manufacturers
- Municipalities
- Defense contractors
- Hospitals/clinics
- Communication firms

## Some Key Risks Falling Outside the Scope of TRIA

**Non-certified terrorism:** This means an act, including the use of force or violence, of any person or group(s) of persons, whether acting alone or on behalf of or in connection with any organization(s), committed for political, religious or ideological purposes including the intention to influence any government and/or to put the public in fear for such purposes. Acts of domestic terrorism perpetrated by US nationals can be insured.

**Global scope:** Operations of global companies located outside the U.S., its territories or possessions may be covered.

**Biological and chemical attack:** Limited coverage can be made available.

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| <p><b>An act of terrorism must:</b><br/>be violent or dangerous to human life or property or infra-structure and be committed by someone acting on behalf of a foreign person or interest, as a part of an effort to coerce the civilian population of the U.S. or to influence the policy or affect the conduct of the US government by coercion, and</p> | <p><b>An act of terrorism must:</b><br/>be an act committed by any person or group(s) of persons, whether acting alone or on behalf of or in connection with any organization(s), committed for political, religious or ideological purposes, including (but not limited to) the intention to influence any government and/or to put the public in fear for such purposes, and</p> | <p>TRIA wording is very specific that (1) the act is violent or dangerous to human life, property or infrastructure and (2) the event be perpetrated by a person acting on behalf of a foreign person or interest. This would necessarily exclude all acts perpetrated by US domestic organizations or individuals, for example, a US-based extremist religious or political group (e.g., (Federal Building in Oklahoma City).</p> |
| <p>occur within the US (or outside in the case of certain air carriers, vessels or U.S. missions) and,</p>   | <p>Occur to property owned by the insured and located in any jurisdiction as specified in the contract.<br/>Can provide protection of all assets.</p>  | <p>TRIA limits its coverage to protecting US assets in the US and its territories only, US flagged aircraft or vessels. Stand alone insurance is available to assets of US and foreign companies operating anywhere in the world.</p>  |
| <p>be "certified" by the US Secretary of Treasury, Attorney General and US Secretary of State. The certification is final and not subject to judicial review.</p>  | <p>Burden of proof falls on the Insured.</p>   | <p>There is some concern as to speed at which TRIA cases could be settled considering the political ramifications and financial impact of certifying an event as a terrorist event.</p>  |
| <p>must exceed \$5 million in the aggregate of all losses to fall under program</p>  | <p>No specific minimums</p>  | <p>Damage to small locations may be excluded from TRIA protection.</p>   |
| <p><b>OTHER ISSUES</b></p>   | <p><b>OTHER ISSUES</b></p>   |  |
| <p>Program existence only guaranteed for three year.</p>   | <p>As long as commercially viable</p>  | <p>Long term investments/projects could find themselves without coverage in three years if TRIA reinsurance unavailable. Stand-alone coverage, however, can be written to cover policy terms as long as 3-5 years.</p>   |
| <p>Pricing erratic - often straight percentage of property premium, due to inexperience and lack of models.</p>  | <p>Stand alone market has had longer experience in modeling and pricing risks, tracking aggregations by metro and suburban areas, and industry.</p>  | <p>Specialist firms may offer broader range of risk assessment capabilities</p>  |
| <p>Insurers are required to accept annual aggregate deductible based on premium volume and 10% coinsurance.</p>  | <p>If a stand alone policy is written by an eligible insurer, they are subject to TRIA's terms and conditions</p>  |  |
| <p>Government can recoup loss payments through property and casualty surcharges (a maximum of 3% unless otherwise determined by Treasury) in years subsequent to loss.</p>   | <p>If a stand alone policy is written by an eligible insurer, they are subject to TRIA's terms and conditions</p>  |  |
| <p>It is unclear whether Insurers are only required to offer coverage once during the policy term.</p>   | <p>Coverage can be placed at any time.</p>   |  |
| <p>The availability of nuclear, biological and chemical (NBC) contamination coverage is policy-specific. If the policy wording does not provide such coverage for other perils, TRIA does not mandate that it be made available for certified terrorism.</p>   | <p>Biological and chemical terrorism can be purchased separately on a limited basis or as part of a stand alone policy.</p>  |  |
| <p>Fire following coverage not uniform.</p>  | <p>Fire following is not excluded.</p>   | <p>If an Insured rejects TRIA coverage, some states require that fire following a TRIA event remains covered, but on a limited basis, viz actual cash value for property and no time element coverage. If stand-alone terrorism is purchased, the property policy and the stand-alone policy have to be coordinated so that the stand-alone applies DIC in those states and territories.</p>                                       |

# Managing Terrorism Risk: Stand Alone Insurance

## Stand alone insurance provides an alternative:

- If you need to provide DIC protection for domestic events not addressed by TRIA such as the Oklahoma City Federal Building.
- If you are seeking potentially more attractive pricing in situations where property premiums are excessive for terror cover.
- If excess capacity is required in a situation where the underwriter is unable to write full line.
- For eligible captive insurers, as reinsurance of deductibles and the 10% coinsurance provision.
- To provide protection for international events.
- To potentially offer some level of biological and chemical terrorism coverage.
- To protect the international supply chain from disruption due to terrorist events.



# Managing Terrorism Risk: Captives

Subsequent to the enactment of the TRIA, the US Treasury issued additional guidance on the eligibility of certain captives and risk retention groups (RRG) to the provisions under the Act. It was determined that any captive or RRG that is licensed by any state, that writes qualified direct property or casualty coverage and that reports direct premiums to that state is subject to TRIA.

It is important that any group operating as such a captive or as a qualified risk retention group recognizes its retention requirements under TRIA: in 2003, the equivalent of 7% of its prior year's written earned premium, rising to 10% and 15% in years 2004 and 2005, respectively. Above this, the entity retains a 10% share of its incurred losses. Willis has been successful in arranging stand alone reinsurance policies to cover both the deductible and coinsurance retentions of captives.

Additionally, insureds of such entities would be subject to a potential "recoupment" surcharge in the event the federal government makes certain payments under the program. Such surcharge could be equal to 3% of the premium charged by the entities for commercial property or casualty policies.

On the positive side, captives and risk retention groups do not currently benefit from reinsurance support for certified terrorism. Therefore, until now, they were either providing the cover unsupported or excluding it.

For further detail on "Captives and Risk Retention Groups as 'Eligible' Insurers," ask for a copy of the Willis Risk Solutions Property Department: TRIA Bulletins 2 & 3.