# The Evolution of and the Current Situation Regarding Terrorism Insurance and Coverage in the United States

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## PRE- SEPTEMBER 11, 2001 SITUATION

At the time of the attacks of september 11, 2001, traditional war risk exclusions included vague references to terrorism but few contained specific and clear clauses or definitions. A typical property, all risk or business interruption policy contained an exclusion of coverage for:

«Hostile or warlike action in time of peace or war, including action in hindering, combating or defending against an actual, impending or expected attack (i) by any government or sovereign power (de jure or de facto), or by any authority maintaining or using military, naval or air forces; or (ii) by military, naval or air forces; or (iii) by an agent of any such government, power, authority or forces.»

One can readily see the difficulty in excluding losses arising from the September 11 attacks and the lack of a publicly announced responsibility assumed for them.

Inland Marine policies typically exclude coverage arising from:

«All consequences of hostilities or warlike operations (whether there be a declaration of war or not) and further exclude "The consequences of civil war, revolution, rebellion, insurrection or civil strife arising therefrom, or piracy.»

Elements of many of these actions were present on September 11.

Business interruption (loss of profits, or consequential loss) policies typically contain a requirement that a physical damage loss to an insured property is a condition precedent to coverage. The reduction in business travel and economic downturn following the attacks has undoubtedly accounted for substantial economic loss and several lawsuits are pending to address that issue and gain coverage under contingent business interruption policies.

## INSURER ATTEMPTS TO LIMIT OR EXCLUDE COVERAGE

Shortly after the attacks insurers sought to limit their exposure by filing with individual State insurance departments modified policy language to include exclusions of coverage for terrorist acts. Reinsurers, fortunately, are not required to file and seek approval for reinsurance contract language and so are free, subject to market forces, to apply whatever language and coverage their clients will accept whether willingly or begrudgingly.

Many insurers use Insurance Service Office, Inc. (ISO) as their central policy and rate filing organization so that an ISO filing in one state will, when approved, be available to all ISO members. In November 2001 ISO filed modified policy forms in all states and jurisdictions to exclude terrorism coverage from commercial property and liability policies. The filing was subsequently amended for the exclusion to take effect only if an insured damage loss of USD 25 million (EUR 25.6 million) or more had been incurred on a property policy. For commercial liability policies a threshold of serious physical injury to 50 or more persons is required for the exclusion to be applicable. If either threshold is reached the exclusion applies and no coverage is provided for any loss. Terrorism involving nuclear, biological or chemical materials is excluded totally as the thresholds do not apply and no coverage is provided for any loss.

A common definition of terrorism is one of the key features of the wording and, with the exception of New York and California, most other states have approved the ISO wording for commercial lines. At the time of writing Florida, Georgia and Texas are still deliberating. No state has approved, or will approve, any exclusion on personal lines policies. Similarly, workers' compensation insurers have not been permitted to exclude terrorism and, generally, have been unable to obtain a rate surcharge from the state regulators despite incurring estimated gross losses of between USD 1.3 and 2 billion (EUR 1.33 and 2.05 billion). One of the concerns of the states rejecting, or not yet approving, the property exclusionary wording is that the definition of terrorism used is too broad and could be applied to vandalism and hate or bias incidents. In the five states where insurers are presently unable to exclude terrorism they are in the unenviable position of having to continue to provide the coverage to their clients on a gross and net basis as reinsurers have done an excellent job of unifying in the exclusion of such risks, generally adopting the NMA, or similar, clause definitions. This has led to a statement by the President of the New York Insurance Association that: «In New York, every business is able to obtain insurance coverage for terrorists risks, except insurance companies.»

During the hearings of the National Association of Insurance Commissioners (NAIC), comprised of the chief insurance regulator in each state, to consider the terrorism exclusions proposed by ISO and the companies, a definition was adopted to be used as a guide for policy exclusions not covered under any, potential, federal terrorism reinsurance program. This definition reads:

«An act, intentionally dangerous or destructive to human life, health, tangible or intangible property or infrastructure, carried out by a person or group that is not an agent of a sovereign state, but is acting on behalf of an organization based in a country other than the United States, and motivated by political, religious or social beliefs.»

As is often the way this contains elements of the approved ISO exclusionary wording but with sufficient variances to keep many lawyers and consultants busy and prosperous for many years to come.

## THE GROWING ACKNOWLEDGEMENT OF THE ECONOMIC CONSEQUENCES OF LACK OF TERRORISM COVERAGE FOR COMMERCIAL RISKS.

After the initial, failed, attempts to gain a federal terrorism program to back-stop the insurance industry a period of several months of quiet lobbying and work has generated a renewed sense of urgency to achieve some sort of safety net for the industry. Through various government agencies, the Bush Administration has become an increasingly forceful supporter of a federal program as a way of ensuring that the general economic recovery not be stunted by the refusal of lending organizations to fund construction and other real estate projects. Whether this will be successful remains to be seen.

A General Accounting Office (GAO) report published in February 2002 indicated that insureds in major metropolitan area were experiencing difficulty in obtaining any coverage against terrorism or, if available, at an affordable cost. Construction projects and large real estate transactions have been delayed and, in some cases cancelled. Insurers have been much more selective in offering terrorism coverage, if at all, and, in turn, several large insurers have purchased reinsurance protection to cover at least a portion of their existing liabilities.

With the gradual shift in exposure back to policyholders the GAO report acknowledged that another major terrorist event would cause a broader economic impact than the September 11 attacks as the economic cost would fall more heavily on businesses than on insurers. This assumes, of course, that such an attack took place after the inclusion on renewal of most current policies of terrorism exclusions. As a result, the GAO concluded that action by Congress to implement a federal terrorism plan is «properly a matter of public policy» and that the failure to implement such a plan could have: «debilitating financial consequences for businesses, their employees, lenders, suppliers and customers.» The report acknowledges that delay in implementation will cause the government difficulties if it waits to act until after a further attack as a plan then would be» difficult to implement quickly – and extremely expensive.» As noted earlier, this report was issued in February and by the end of May, 2002 a federal terrorism reinsurance plan appears to be little closer to being adopted.

## THE STATUS OF LEGISLATION AND PROSPECTS FOR PASSAGE

After the initial intense industry lobbying and many and varied proposals were considered, argued over and modified, a Bill (H.R 3210) was passed by the House of Representatives on November 29, 2001 which, if enacted (which it won't be) would be called the Terrorism Risk Protection Act.

This provides for a complex formula whereby a three - year federal government loan guarantee for domestic acts of terrorism would be activated by one of two triggers, either an industry-wide commercial lines retained loss of USD 1 billion (EUR 1.02 billion) or more, or by USD 100 million (EUR 102.4 million) in industry-wide commercial lines losses and for each affected insurer losses exceeding 10% of policyholders' surplus and 10% of the commercial lines net written premium. Loans under the program would be repaid by insurers, probably as an assessment on policyholders.

The industry has not reacted favorably to this Bill arguing that the formula is too complex and some criticism that the activating triggers are too high. However, at least it is a plan but it is very much on hold as the Senate debates and considers whether to adopt its own plan, or not adopt any plan at all. In the event that the Senate does pass a Bill the procedure is then for a joint House and Senate conference to be empowered to agree a compromise Bill for submission back to each chamber and, if approved, the Bill is then sent to the President for signature and enactment.

The current Senate Bill under consideration since late 2001, provides for a USD 10 billion (EUR 10.24 billion) industry retention above which the federal government would assume 90% of claims above that figure. This Bill has become stalled over fundamental differences between Democrats and Republicans concerning tort issues. Republicans, backed by the Bush Administration, are trying to prevent a lawyer bonanza from a terrorist act by prohibiting punitive damages awards to victims, limit other non-economic damages (pain and suffering, for example) and cap attorneys' fees. The Democrats oppose these features hence the deadlock.

Prospects for passage have dimmed in the past month as conflicting information is disseminated concerning the effects on the economy and, barring either another terrorist attack or a major breakthrough over the main areas of disagreement, at present it is difficult to see how the Senate could pass any Bill. This leaves industry with a huge problem but one that dissipates somewhat as insurance policy renewals are processed absent terrorism coverage. With exclusions barred in New York and California, probably the two states most likely to be affected by a future major terrorist attack, insurers remain very vulnerable.

A further area of concern, and where coverage has not been eliminated, is the adherence, in about 50% of states and accounting for approximately 70% of property premium income, to the wording of the Standard Fire Policy. This long used policy language contains a war exclusion clause that has been subject to liberal interpretation in the courts. Consequently, despite the terrorism exclusion, property insurers could still be in the unenviable position of believing they were excluding terrorist acts yet, for fire losses only, they were not, in fact, able to so. ■