TERRORISM AND INSURANCE

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The September 11, 2001 terrorist attack resulted in an estimated $32.5 billion in insured losses. Those losses occurred across many types of coverage, including commercial property, business interruption, workers compensation, aviation, life and disability insurance. Future attacks on U.S. soil are also likely to trigger a wide range of insurance coverages, depending on the type of event and whether policyholders have purchased terrorism insurance.

Terrorism insurance: what it is and what it covers

Terrorism insurance provides coverage to individuals and businesses for potential losses due to acts of terrorism.

Businesses

Prior to 9/11, standard commercial insurance policies included terrorism coverage as part of the package, effectively free of charge. Today, terrorism coverage is generally offered separately at a price that more adequately reflects the current risk.

Insurance losses attributable to terrorist acts under these commercial policies are insured by private insurers and reinsured or “backstopped” by the federal government pursuant to the Terrorism Risk and Insurance Act of 2002 (TRIA). Under TRIA, owners of commercial property, such as office buildings, factories, shopping malls and apartment buildings, must be offered the opportunity to purchase terrorism coverage. A June 2004 report from insurance broker Marsh, Inc., found that the proportion of U.S. businesses that purchased terrorism during the first quarter of 2004 rose to its highest level since the enactment of TRIA in November 2002. According to Marsh, 44.2 percent of U.S. businesses obtained coverage in the first quarter of 2004, up from 32.7 percent in the fourth quarter of 2003.

Individuals

Standard homeowners insurance policies include coverage for damage to property and personal possessions resulting from acts of terrorism. Terrorism is not specifically referenced in homeowners policies. However, the policy does cover the homeowner for damage due to explosion, fire and smoke—the likely causes of damage in a terrorist attack.

Condominium or co-op owner policies also provide coverage for damage to personal possessions resulting from acts of terrorism. Damage to the common areas of a building like the roof, basement, elevator, boiler and walkways would only be covered if the condo/co-op board has purchased terrorism coverage.

Standard renters policies include coverage for damage to personal possessions due to a terrorist attack. Again, coverage for the apartment complex itself must be purchased by the property owner or landlord.

Auto insurance policies will cover a car that is damaged or destroyed in a terrorist attack only if the policyholder has purchased “comprehensive” coverage. Most people who have loans on their cars or lease are required by lenders and leasing companies to carry this optional form of coverage. People who buy liability coverage only are not covered in the event their vehicle is damaged or destroyed as the result of a terrorist attack.

Life insurance policies do not contain terrorism exclusions. Proceeds will be paid to the beneficiary as designated on the policy.

Under what circumstances is there coverage?

For the terrorism coverage to be triggered under TRIA for commercial policies, a terrorist attack has to be declared a "certified act" by the Secretary of the Treasury.

No such declaration is needed to trigger coverage under home and auto policies because there are no exclusions for terrorism.

In some states a doctrine know as "fire following" applies. This means that in the event of a terrorist-caused explosion followed by fire, insurers could be liable to pay out losses attributable to the fire (but not the explosion) even if a commercial property owner had not purchased terrorism coverage. Insurers are now seeking to limit fire coverage resulting from a terrorist attack, because commercial policyholders that choose to reject TRIA or other terrorism coverage are effectively paying no premium for the protection offered by fire-following coverage. So far, seven states have amended their standard fire policy laws to exclude acts of terrorism.

What is not covered?

There are long-standing restrictions regarding war coverage and nuclear, biological, chemical and radiological (NBCR) events in both personal and commercial insurance policies.

War-risk exclusions reflect the realization that damage from acts of war is fundamentally uninsurable. No formal declaration of war by Congress is required for the war risk exclusion to apply. Nuclear, biological, chemical and radiological attacks are another example of catastrophic events that are fundamentally uninsurable due to the nature of the risk. Under the Terrorism Risk Insurance Act (see below), if some NBCR exclusions are permitted by a state, an insurer does not have to make available the excluded coverage.

Business Interruption Insurance

Property damage to commercial buildings from a terrorist attack also may include claims for business interruption. Business interruption insurance (sometimes referred to as business income coverage) covers financial losses that occur when a firm is forced to suspend business operations either due to direct damage to its premises or because civil authorities limit access to an area after the attack and those actions prevent entry to the business premises. Coverage depends on the individual policy, but typically begins after a waiting period or "time deductible" of two to three days and lasts for a period of two weeks to several months.

Business interruption losses associated with acts of civil authority (e.g., closure of certain area around the disaster) can only be triggered when there is physical loss or damage arising from a covered peril (e.g., explosion, fire, smoke, etc.) within the area affected by the declaration. The loss/damage need not occur to the insured premises specifically. Reductions in business income associated with fear of traveling to a location, in addition to closure to areas by authorities because of a heightened state of alert, would not be covered by business interruption policies.

Workers compensation and other coverages

Workers compensation -- a compulsory line of insurance for all businesses -- covers employees injured or killed on the job and therefore automatically includes coverage for acts of terrorism. Workers compensation is also the only line of insurance that does not exclude coverage for acts of war. Coverage for terrorist acts cannot be excluded from workers compensation policies in any state.

There are essentially three types of workers compensation benefits. The first reimburses workers for lost wages while they recover from their injuries. The second covers workers for all medical expenses incurred as a result of the injuries they sustain. The third type of benefit provides payments to the families of workers killed on the job.

Life/health and disability insurance policies may provide coverage for loss of life, injury or sickness to individuals in the event of a terrorist attack.

What is the Terrorism Risk Insurance Act (TRIA)?

TRIA is a public/private risk-sharing partnership between the federal government and the insurance industry. The program is designed to ensure that adequate resources are available for businesses to recover and rebuild if they become the victims of a terrorist attack.

Specific provisions of the legislation are:

- An event must cause at least $5 million in aggregate property and casualty insurance losses to be certified by the Secretary of the Treasury as an act of terrorism.

- The bill is limited to international terrorism committed on behalf of any foreign person or foreign interest on U.S. soil. (Damage to an air carrier or vessel outside the U.S., or to a the premises of a U.S. mission is covered by TRIA, however)

- Each participating insurer is responsible for paying out a certain amount in claims – a deductible -- before Federal assistance becomes available.

- For losses above a company's deductible, the federal government will cover 90 percent, while the insurer contributes 10 percent.

- The aggregate insurance industry retention in 2004 is $12.5 billion in 2004 and $15 billion in 2005.

- Losses covered by the program are capped at $100 billion.

- Lines excluded from the program are: personal lines (auto and home), assumed reinsurance, federal crop, mortgage guaranty, financial guaranty, medical malpractice, flood insurance and life & health.

- The Act sunsets after three years on December 31, 2005.

Does TRIA affect the availability and price of coverage?

Yes, by sharing potential losses from terrorist attacks between private insurers and the government, TRIA has brought much needed additional capacity to the terrorism market. Before

TRIA, businesses were left with little or no terrorism coverage, but now they are able to purchase the cover they need.

Terrorism coverage is very difficult to price because the frequency and severity of an attack is so unpredictable. Pricing of terrorism coverage varies according to the individual risk (based on factors such as location and industry, for example), but it is clear that TRIA has had a stabilizing influence on the market.

Does an insurer have to make terrorism coverage available?

Yes. Under TRIA, all property and casualty insurers in the U.S. are required to make terrorism coverage available. The “make available” provision applies to commercial lines of p/c insurance. Insurers are required to make an offer of coverage for “certified acts” to policyholders. If the insured rejects an offer, the insurer may then reinstate a terrorism exclusion.

Under TRIA, the “make available” provision was scheduled to sunset at the end of 2004. However, in June 2004, the Treasury Department extended this provision through the end of 2005.

What if terrorism coverage has not been purchased and a loss occurs?

A business that has not purchased TRIA or other terrorism coverage will not be covered for damage caused to their property by a terrorist attack. An individual that has homeowners or renters coverage may be covered, according to the individual terms of their policy.

Will TRIA expire? What happens if it does?

TRIA is scheduled to expire on December 31, 2005 and the threat of future catastrophic terrorist attacks on U.S. soil remains very real. Unless TRIA is extended by the United States Congress, any commercial insurance policy with an inception date beyond January 1, 2005 will include a period where no federal “backstop” is in place. Attacks occurring on or after January 1, 2006 could be financially destabilizing and lead to insurer insolvencies. Consequently insurers and regulators are developing language that would allow insurers to exclude losses associated with terrorist attacks (except workers compensation losses). Regulators in the majority of states approved such exclusions in the pre-TRIA period.

Today, dozens of business groups and professional societies, as well as individual corporate risk managers, insurance agents and brokers support a two-year extension of TRIA. Failure to renew TRIA would leave insurers and the wide range of businesses, organizations and individuals that they service, vulnerable to economic disaster in the event of another catastrophic terrorist attack.