TERRORISM RISK: A REEMERGENT THREAT

Impacts for Property/Casualty Insurers

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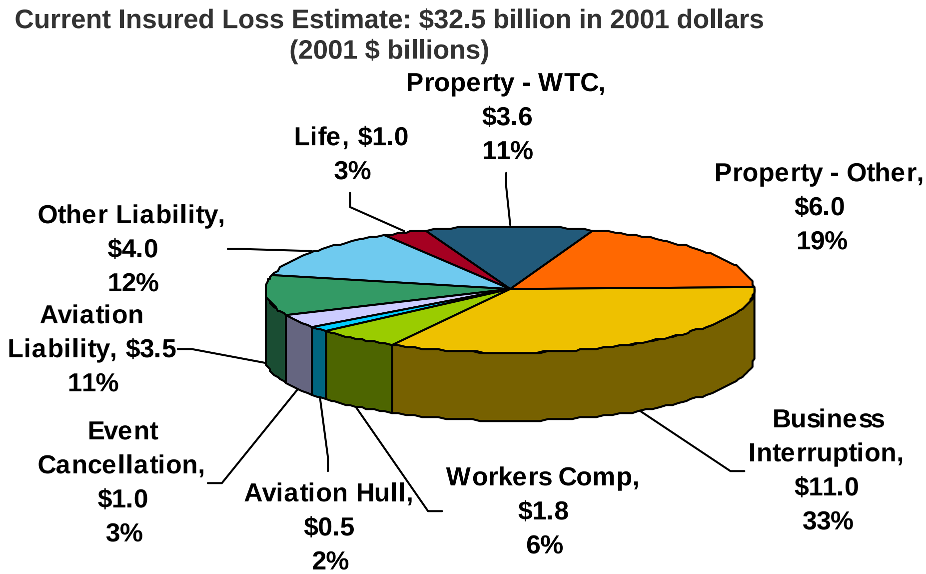
Introduction

International terrorism – starting with the terrorist attack of September 11, 2001, and followed by the 2002 Bali bombings, the 2004 Russian aircraft and Madrid train bombings, the London transportation bombings of 2005, and the Mumbai bombings of 2008 – had a profound influence on the past decade. Two wars later the immediate human and economic toll of these events may have subsided, but recent developments such as the March 29 Moscow subway bombings, the attempted and thwarted attacks on board aircraft, the thwarted plan by Najibullah Zazi to bomb the New York subway system, the upcoming high profile trial of the Guantanamo 9/11 suspects (perhaps to be held in New York City), and elevated terrorism threat levels issued by a number of countries are propelling terrorism into the headlines once more. All these factors suggest that terrorism risk will be a constant and perhaps growing threat for the decade ahead.

For property/casualty insurers and reinsurers, the impact of the terrorist attack of September 11, 2001 was substantial – producing insured losses of about $32.5 billion, or $39.4 billion in 2009 dollars. Losses were paid out across many different lines of insurance, including property, business interruption, aviation, workers compensation, life and liability ***(Figures 1 and 2)***. The loss total does not include the March 2010 settlement of up to $657.5 million announced by New York City officials and plaintiffs' lawyers to compensate about 10,000 workers whose health was damaged during the rescue and cleanup at the World Trade Center (see later section: Ground Zero Workers and Health Claims).

A total of 2,976 people lost their lives in the September 11, 2001 terrorist attacks in New York, Washington, D.C. and Pennsylvania, excluding the 19 hijackers. It remains the worst terrorist attack on record in terms of fatalities and insured property losses, which totaled about $23 billion (in 2009 dollars) ***(Figure 3)***. In the nearly nine years since 9/11 insurers have paid out many billions of dollars for other catastrophes, but until Hurricane Katrina in 2005 when insurers paid claims totaling more than $40 billion, 9/11 was the largest loss in the global history of insurance.

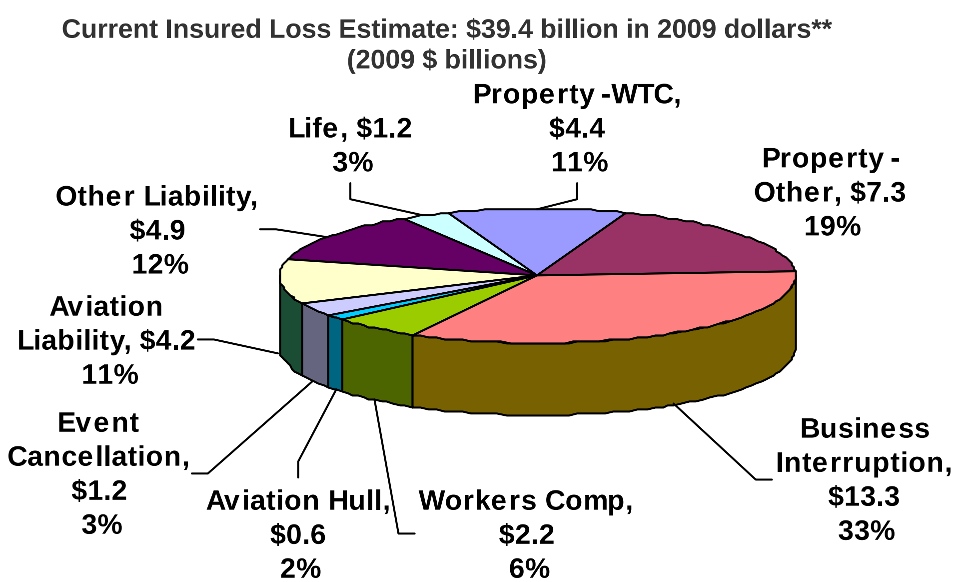
Figure 1
Sept 11 Industry Loss Estimates*



*Loss total does not include NYC March 2010 settlement of up to $657.5 million to compensate about 10,000 Ground Zero workers.

Source: Insurance Information Institute

Figure 2
Sept 11 Industry Loss Estimates*



*Loss total does not include NYC March 2010 settlement of up to $657.5 million to compensate about 10,000 Ground Zero workers.

** Sum of segment totals may not equal overall total due to rounding. Adjusted to 2009 dollars using Bureau of Labor Statistics (BLS) inflation calculator.

Source: Insurance Information Institute

Figure 3
WORST TERRORIST ACTS, INSURED PROPERTY LOSSES

(2009 $ millions)

Rank	Date	Country	Location	Event	Insured property loss (1)	Fatalities
1	Sep. 11, 2001	U.S.	New York City, Washington, D.C.	Hijacked airliners crash into World Trade Center and Pentagon	$22,747 (2)	2,976 (3)
2	Apr. 24, 1993	U.K.	London	Bomb explodes near NatWest tower in the financial district	1,070	1
3	Jun. 15, 1996	U.K.	Manchester	Irish Republican Army (IRA) car bomb explodes near shopping mall	878	0
4	Apr. 10, 1992	U.K.	London	Bomb explodes in financial district	792	3
5	Feb. 26, 1993	U.S.	New York City	Bomb explodes in garage of World Trade Center	757 (2)	6
6	Jul. 24, 2001	Sri Lanka	Colombo Intl. Airport	Rebels destroy 3 airliners, 8 military aircraft and heavily damage 3 civilian aircraft	469	20
7	Feb. 9, 1996	U.K.	London	IRA bomb explodes in South Key Docklands	305	2
8	Apr. 19, 1995	U.S.	Oklahoma City	Truck bomb crashes into government building	176 (2)	166
9	Dec. 21, 1988	Scotland	Lockerbie	PanAm Boeing 747 explodes	162	270
10	Sep. 12, 1970	Jordan	Zerqa	Hijacked Swissair DC-8, TWA Boeing 707 and BOAC VC-10 dynamited	149	0
11	Mar. 11, 2004	Spain	Madrid, Atocha	Bomb attack on trains	139	191
12	Sep. 6, 1970	Egypt	Cairo	Hijacked PanAm B-747 dynamited	131	0

(1) Includes bodily injury and aviation hull losses. Originally reported in 2001 dollars by Swiss Re. Adjusted to 2009 dollars by the Insurance Information Institute using the Bureau of Labor Statistics' Inflation Calculator.
(2) Updated by the Insurance Information Institute to reflect latest estimate from ISO.
(3) Latest government figures.

Source: ISO's Property Claim Services unit (PCS); Swiss Re; U.S. Bureau of Labor Statistics.

As construction moves ahead on One World Trade Center (a.k.a. Freedom Tower) insurance claims dollars continue to play an essential and highly visible role in rebuilding lower Manhattan. The many billions of dollars in insurance payouts has also mitigated the overall economic impact of the 9/11 attack – estimated initially by the Milken Institute at approaching $200 billion overall.

Before 9/11 terrorism exclusions were virtually nonexistent in commercial insurance contracts sold in the United States. Following the attack, insurers moved to exclude coverage. Only when the Terrorism Risk Insurance Act (TRIA) was enacted by Congress in November 2002 did coverage for terrorist attacks resume. TRIA established a public/private risk-sharing partnership that allows the federal government and the insurance industry to share losses in the event of a major terrorist attack. 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.

Since its initial enactment in 2002 the terrorism risk insurance program has been revised and extended twice. The most recent extension – the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) – ensures its existence until December 31, 2014. However, the portion of the loss insurers would pay in the event of a terrorist attack has increased significantly over the years. Insurers are also solely responsible for terrorism losses that impact non-TRIA lines, such as private passenger auto and homeowners insurance and group life. Less than half of the property/casualty insurance premiums are written in lines of insurance backstopped by TRIPRA. Today, provisions of the terrorism risk insurance program are again under attack. The Obama administration's 2011 budget plan includes a proposal seeking to scale back federal support for the program. A 2009 report by insurance broker Aon estimated that some 70 percent to 80 percent of the commercial property insurance market would revert to absolute exclusions for terrorism if TRIA is changed.[1]

HOW INSURERS TREAT TERRORISM RISK TODAY

In the immediate aftermath of 9/11 the ability of commercial policyholders to purchase adequate limits of terrorism coverage at affordable prices was severely constrained. Commercial property owners and businesses were faced with substantially reduced protection for terrorism-related risks, in addition to higher property/casualty rates overall. The situation was particularly acute for owners of high profile "trophy" buildings located in major metropolitan

[1] Terrorism Update and Key Metrics Report – May 2009, Aon Risk Services.

areas. As a result, many were forced to go without coverage or only partly insure their assets.

Today, reports of property owners, retail outlets or sporting events having problems securing terrorism coverage due to a lack of capacity in the market are no longer making headline news. For example, recent media reports suggest that major sporting and entertainment events such as the XXI Olympic Winter Games in Vancouver and the upcoming 2010 FIFA World Cup in South Africa successfully secured insurance protection for a range of perils including terrorism coverage.

However, in July 2008 the U.S. Government Accountability Office (GAO) issued a preliminary report on the availability and affordability of terrorism coverage in large metropolitan areas.[2] It found that while commercial property terrorism insurance appears to be available nationwide at rates policyholders believe is reasonable, certain types of policyholders may have more difficulty obtaining the coverage amounts they need at prices they view as acceptable. These policyholders are typically owners of high-value properties in urban areas where there is a high concentration of large buildings that are seen as potential terrorism targets, such as Manhattan.

Industry data shows that take-up rates (the proportion of businesses buying insurance) for terrorism coverage climbed steadily in 2003, 2004, 2005 and 2006 as businesses across the United States had the opportunity to purchase terrorism coverage, usually at a reasonable cost. More recently take-up rates for terrorism coverage – the percentage of firms buying the insurance – appear to have stabilized, though this is not thought to be a permanent trend. Take-up rates for workers compensation terrorism coverage are effectively 100 percent as this is a compulsory line of insurance for all businesses.

In a May 2009 report insurance broker Aon found that more than 63 percent of its clients purchased some form of coverage, down from 69 percent in 2008. Aon said the decrease is most likely temporary due to shifts in renewal patterns tied to natural catastrophes as policyholders move more renewals to the second quarter. It expected the take-up rate to increase with second quarter renewals. Clients most likely to include terrorism coverage as part of their property insurance were the largest firms and entities, including financial services institutions, real estate, entertainment businesses and healthcare facilities, Aon said.

[2] Initial Results on Availability of Terrorism Insurance in Specific Geographic Markets, GAO-08-919R, July 2008.

A standalone market for terrorism insurance coverage also exists. In its report, Aon observed that a substantial portion of the premium paid to the insurance markets by its clients for terrorism risk transfer falls within this sector. According to the study, the standalone terrorism market remains the market for difficult risks, has a history of paying global claims and, unlike the terrorism risk insurance program, it relies upon private capital commitments (although some of the standalone markets do rely on TRIA as a partial reinsurance backstop).

Aon reports that approximately 40 percent of the demand for standalone capacity comes out of North America (down from 50 percent-plus as of 2007) and that growth areas for this product are emerging out of South America, Eastern Europe and Asia.

According to insurance broker Marsh, the latest extension to the terrorism risk insurance program which eliminates any distinction between domestic or foreign acts of terrorism in the definition of a certified act of terrorism has also acted as an impetus for standalone markets to offer more competitive terms and conditions to insureds.

ESTIMATING POTENTIAL TERRORISM LOSSES

The fact that acts of terrorism are intentional and that the frequency and severity of attacks cannot be reliably assessed makes terrorism risk extremely problematic from the insurance standpoint. Many insurers continue to question whether terrorism risk is insurable. Large segments of the economy and millions of workers are exposed to significant terrorism risk, but the ability to determine precisely where or when the next attack may occur is limited.

At any given time, there are a range of viewpoints among industry analysts and national security experts on where the terrorist threat is highest and which country or location is most at risk. When it comes to estimating losses from potential terrorist attacks there also appears to be significant variability in outcomes, underscoring the degree of uncertainty associated with potential terrorist attacks.

Despite the differing viewpoints, the overall consensus appears to be that terrorism risk is an ongoing and in some cases growing threat. Here are some of the most recent projections and predictions on the terrorism threat:

- **Transit System Threat:** Following the March 29, 2010 attacks by suicide bombers on the Moscow subway that killed 39 people, New York City

Mayor Michael Bloomberg announced that the New York City Police Department (NYPD) has stepped up its patrol of the subways. "We will learn from the terrible tragedy in Moscow, and we will continue to do everything possible to protect our transit system – and our entire city – from the threat of terrorism," Bloomberg said.

- **Cyber Terrorism:** FBI director Robert Mueller says the threat of cyber terrorism is real and rapidly expanding and warns that militant groups, foreign states and criminal organizations pose a growing threat to U.S. security as they target government and private computer networks.[3] Speaking at an Internet security conference in March 2010, Mueller said militant groups like al Qaeda had primarily used the Internet to recruit members and plan attacks, but they have shown a clear interest in combining physical attacks with cyber attacks. Mueller's comments follow a number of recent international Internet security incidents including an attack in January 2010 on computer networks at Google and around 30 other U.S. corporations that is believed to have originated in China.

- **Maritime Threat:** On March 3, 2010, the Singapore navy warns that a terrorist group may be planning attacks on oil tankers in the Strait of Malacca, one of the world's busiest shipping lanes. An advisory issued by the Singapore navy Information Fusion Centre (IFC) recommends that ships should "strengthen their on-board security measures and adopt community reporting to increase awareness and strengthen the safety of all seafarers."

- **Country Risk:** A global ranking of 196 countries by risk analyst Maplecroft published in February 2010 rates Iraq as the country most at risk for terrorist attacks for the second year running, followed by Afghanistan, Pakistan and Somalia. Other extreme risk nations are Lebanon, India, Algeria, Colombia and Thailand.

- **Economic Threat:** The World Economic Forum Global Risk Report 2010 reports that international terrorists continue to mount sizeable attacks, causing significant economic and human losses. Drivers of increasing risk include: instability on the Indian sub-continent, particularly Indo-Pakistani relations but also indigenous movements such as Naxalites; the level of political radicalization from the economic crisis; weak governance in parts of Africa provides alternative retreat positions to Afghanistan and Pakistan.

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[3] *FBI director warns of growing cyber threat*, by Alexei Oreskovic, Reuters, March 4, 2010.

- **Weapons of Mass Destruction (WMD):** James Jones, White House national security adviser, tells USA Today[4]: "Of all the things that could be the nightmare scenario, what's the biggest nightmare scenario? Thirty years ago, one of my predecessors would have said nuclear war with Russia. Today, as I'm in this chair, I can tell you it's proliferation, the acquisition of a weapon of mass destruction by a terrorist organization."

- **Regional Terrorism Threat:** Aon's 2009 Terrorism Threat Map shows a more settled outlook for North America, Europe and Australia and attributes this to better counter-terrorism capability. However, it warns that the global recession could lead to a new generation of terrorists emerging from disaffected communities in a re-emergence of class-based politics. With the election of a more liberal President in the United States, uplift in activity from domestic far right and militia groups is possible, according to Aon. The map also shows a trend towards fewer terrorist attacks in the Middle East but increased activity in Pakistan, India and Afghanistan, with Thailand and Nepal showing higher levels of activity.

- **Insured Loss Estimates:** In July 2008, risk modeling firm Risk Management Solutions (RMS), put potential insured losses from a terrorist attack in the United States at $1.6 billion, an increase of 8 percent on the previous year. RMS says terrorism targets are more likely to be in the commercial or private sector, such as sports stadiums, now that governments' counter-terrorism efforts have been stepped up.

TERRORISM RISK INSURANCE PROGRAM: STRUCTURE AND COVERAGE

The Terrorism Risk Insurance Act of 2002 was adopted by Congress to ensure the widespread availability and affordability of property and casualty insurance for terrorism risk. The act provides a temporary program, or "backstop" for incurred losses resulting from certain acts of terrorism.

The Act was extended in 2005 for two years and again in 2007 for another seven years through December 2014 under the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA). Both extensions of the Act changed some components of the program, increasing the portion of the loss insurers would pay in the event of a terrorist attack and reducing the types of commercial insurance covered by the program.

It is important to note that the program provides no coverage for personal lines insurers, reinsurers and group life insurance losses (see below).

[4] *What's our Next Terror Threat?* by Susan Page, Thomas Frank and Kevin Johnson, USA Today, 1/26/2010.

The major provisions of the terrorism risk insurance program are as follows:

- **Make available requirement:** Only commercial insurers and causes of loss specified in the underlying policies are covered under the program and required to make coverage available. Residual market insurers such as workers compensation pools, captive insurers and risk retention groups are also covered. Personal lines insurers and reinsurers are not covered, neither are group life insurance losses. Most types of commercial insurance lines were covered under the original legislation, except for some specialty coverages such as medical malpractice and crop insurance. Under the 2005 extension, certain additional lines are now excluded:

  - Commercial automobile
  - Burglary and theft
  - Surety
  - Professional liability except for directors and officers liability
  - Farm owner multi-peril insurance

- **Definition of a certified act of terrorism:** The 2007 extension expanded the definition of a certified act of terrorism to eliminate any distinction between domestic or foreign acts of terrorism. The original act covered only acts of foreign terrorism on U.S. soil.

- **Triggering event:** The threshold for the program to go into effect rose from $5 million under the original Act to $50 million after March 2006. In 2007, the triggering event threshold rose to $100 million and remained there under TRIPRA. Federal funds will be paid out only in the event of a terrorist act that produces total insurance industry losses above this threshold.

- **Program cap:** The program is capped at $100 billion per year for insured losses (federal and insurer combined). A provision in the law requires the U.S. Department of the Treasury to establish a process for the allocation of pro-rata payments in the event that terrorism-related insured losses exceed the federal government’s annual $100 billion cap. The law states that no insurer may be required to make any payment for insured losses in excess of its deductible and its share of insured losses.

- **Individual insurer deductibles:** The amount of terrorism losses that an individual insurer must pay before federal assistance becomes available. The level rose to 20 percent of an insurer’s direct earned premiums for commercial property/casualty insurance in 2007 where it currently remains (up from 17.5 percent in 2006 and 15 percent in 2005).

- **Co-payments:** The share of losses that insurers pay above their individual retentions – rose to 15 percent in 2007 where it remains today, up from 10 percent in 2006.

- **Industry retention level:** The industry as a whole must cover a certain proportion of the losses through deductibles and copayments before federal assistance kicks in. This amount rose to $27.5 billion in 2007 where it remains today, up from $25 billion in 2006 and $15 billion in 2005. If the insured loss is less than the $27.5 billion threshold, the federal government can recoup the difference between the actual amount it paid and the required retention. This comes via a surcharge on commercial insurance policyholders not to exceed 3 percent of premium for insurance coverages that fall under the program. If the insured loss exceeds this threshold, federal expenditures may be recouped for amounts in excess of the threshold at the discretion of the Secretary of the Treasury.

FEDERAL ROLE IN TERRORISM INSURANCE

The Obama administration's 2011 budget plan includes a proposal seeking to scale back federal support for the terrorism risk insurance program. Its justification is that this would "encourage the private sector to better mitigate terrorism risk through other means, such as developing alternative reinsurance options and building safer buildings." The proposal projects savings of $249 million in the course of the next 10 years as a result of the reduction in federal support.

Industry observers note that any attempts to modify the program would have a detrimental effect on the availability and affordability of terrorism insurance – problems that the program was designed to end. They doubt that Congress would be willing to reopen debate on the provisions in the legislation in the absence of a terrorist attack that triggered federal payments. The projected savings would only be realized if there was such an event.

Studies by various organizations, including the University of Pennsylvania's Wharton School Risk Center, the RAND Corporation and the Organization for Economic Co-operation and Development (OECD), have supported the idea for a substantive federal role in terrorism insurance. In particular, the Wharton School found that TRIA has had a positive effect on availability of terrorism coverage and also has significantly contributed to reducing insurance premiums.[5] The OECD also notes that thus far the financial markets have shown little appetite for terrorism risk.

Terrorism Risk Insurance Programs in Other Countries

A number of countries have established their own terrorism risk insurance programs and these have operated successfully, often for many years. Australia, Austria, Belgium, France, Germany, the Netherlands, Spain, Switzerland and the United Kingdom have all created programs to cover terrorism in the event of an attack on their own soil. In 1993, the British government formed a mutual reinsurance pool for terrorist coverage following acts of terrorism by the Irish Republican Army. Insurance companies pay premiums at rates set by the pool. The primary insurer pays the entire claim for terrorist damage but is reimbursed by the pool for losses in excess of a certain amount per event and per year. This is based on its share of the total market. The maximum industry retention increases annually per event and per year. Following 9/11, coverage was extended to cover all risks, except war, including nuclear and biological contamination, aircraft impact and flooding, if caused by terrorist attacks. The British government acts as the reinsurer of last resort, guaranteeing payments above the industry retention.

Fire Following

State law has also addressed the issue of terrorism cover. Before 9/11, 31 jurisdictions had laws that required that property policies be based on the 1943 New York Standard Fire Policy (SFP).[6] The SFP does not exclude fire following terrorism and, prior to 2003, the SFP did not permit this exclusion with the result that a policyholder who had rejected terrorism coverage under TRIA would still have coverage for fire following an act of terrorism. Currently, this is still the case in just five states – California, Maine, Missouri, Oregon and Wisconsin.

However, since 2003, some states have revised their SFP statutes to permit exclusions of fire following terrorism under certain circumstances. Thus, for a policyholder who has rejected terrorism coverage under TRIA, in these states there might be no coverage or limited coverage for fire resulting from an act of terrorism. Many states do not have a standard fire policy statute or have

[5] *Evaluating the Effectiveness of Terrorism Risk Financing Solutions*, Howard C. Kunreuther and Erwann O. Michel-Kerjan, September 2007, National Bureau of Economic Research.
[6] Global Terror Update 2009, Guy Carpenter.

SFPs that unconditionally exclude fire following terrorism. In these states there is no stipulated coverage for fire following terrorism.

NUCLEAR, BIOLOGICAL, CHEMICAL AND RADIOLOGICAL (NBCR) THREAT

Acts of terrorism have the potential to be large, destabilizing events, giving rise to losses of an unquantifiable size and severity. Potential terrorism scenarios often include the likely impact of an incident involving weapons of mass destruction (WMD).

As recently as January 2010 the U.S. Government Accountability Office (GAO) stated that a terrorist's use of either a radiological dispersal device (RDD) – frequently referred to as a dirty bomb – or an improvised nuclear device (IND) to release radioactive materials into the environment could have devastating consequences.[7] It noted that the consequences of a terrorist attack using an RDD or IND would include not only loss of life but also enormous psychological and economic impacts.

An April 2006 study by the American Academy of Actuaries explored the insured losses that nuclear, biological, chemical and radiological (NBCR) incidents might give rise to in four U.S. cities. It estimated that in New York a large NBCR event could cost as much as $778.1 billion, with insured losses for commercial property at $158.3 billion and for workers compensation at $483.7 billion. A loss of this magnitude is more than three times the size of the commercial p/c insurance industry's claims-paying capacity. The three other U.S. cities included in the analysis were Washington, DC; San Francisco, CA and Des Moines, IA.

Nuclear, biological, chemical and radiological attacks are another example of catastrophic events that are fundamentally uninsurable due to the nature of the risk. The Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) did not include an earlier controversial provision that would have required insurers to make available coverage for NBCR attacks. There are long-standing restrictions regarding war coverage and NBCR events in both personal and commercial insurance policies.

The reauthorization of the terrorism risk insurance program in 2007 directed GAO to review: the extent to which insurers offer NBCR coverage; factors that contribute to the willingness of insurers to provide NBCR coverage, and;

[7] Combating Nuclear Terrorism: Actions Needed to Better Prepare to Recover from Possible Attacks Using Radiological or Nuclear Materials, Government Accountability Office (GA0), January 2010, GAO-10-204.

policy options for expanding coverage for NBCR risks. In its report, GAO said that commercial property/casualty insurers generally still seek to exclude NBCR coverage per long-standing exclusions for nuclear and pollution risks, although such exclusions may be subject to challenges in court because they were not specifically drafted to address terrorist attacks.[8]

GAO noted that commercial property/casualty policyholders, including companies that own high-value properties in large cities, generally reported that they could not obtain NBCR coverage. Unlike commercial p/c insurers, workers' compensation, group life and health insurers reported generally providing NBCR coverage because states generally do not allow them to exclude these risks. GAO reviewed several proposals but made no recommendations on the NBCR issue.

AVIATION INSURANCE FOR TERRORISM RISKS

Aviation insurance for terrorism risks continues to be an issue of concern for countries around the world. The attempted Christmas Day attack on a Northwest Airlines flight from Amsterdam to the United States by Umar Farouk Abdulmutallab who allegedly tried to detonate plastic explosives hidden in his underwear is the latest reminder that terrorists continue to look for opportunities to target international aviation.

Airlines are required to have passenger and third-party liability insurance coverage to receive landing rights and as a condition for leases, so the cancellation of insurance cover could affect the industry's ability to operate.[9] In the wake of 9/11, there was a complete withdrawal of coverage for acts of war, terrorism and related perils. As a result a number of governments stepped in and established schemes to temporarily fill the coverage gap. Since then, the private market has partially reinstated coverage, though at a significantly higher cost.

Some countries, like the U.S., assist airlines in insuring war risks. The Federal Aviation Administration (FAA) began issuing premium third party liability war risk insurance to U.S. air carriers in the wake of 9/11. The Homeland Security Act of 2002 (HAS) and subsequent legislation mandated the expansion of war risk insurance coverage to include hull loss and passenger liability and required continued provision of the insurance.

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[8] Terrorism Insurance: Status of Coverage Availability for Attacks Involving Nuclear, Biological, Chemical or Radiological Weapons, U.S. Government Accountability Office (GAO), December 2008
[9] Global Terror Update 2009, Guy Carpenter

The program has been extended several times. As of September 1, 2009, the FAA Aviation Insurance Program Office provides war risk hull loss, and passenger, and third party liability insurance to regularly scheduled U.S. air carriers for the period through August 31, 2010.

THE LIABILITY FACTOR

Another distinguishing feature of terrorist attacks is their ability to generate enormous liability losses in addition to physical losses. In the immediate aftermath of 9/11 it became clear that thousands of victims and their families were prepared to litigate to recover economic and non-economic (e.g., pain and suffering, emotional distress, etc.) damages.

To minimize the likelihood of a wave of liability claims against the airlines and other likely litigants in the days following 9/11, Congress established the Victims Compensation Fund (VCF). The program was designed to provide a no-fault alternative to tort litigation for these individuals or relatives and provided compensation for losses due to personal physical injuries or death.

By the time the VCF ceased operations on June 15, 2004 it had processed nearly 7,400 claims for death and physical injury and provided around $7 billion in payments to families of 9/11 victims. In return, victims' families were required to give up the right to sue the airlines, government agencies or other entities they perceived as responsible parties.

TRIA and its extension legislation contain no provision for handling liability claims in future. As a result, the impact of tort claims following another major terrorist attack on U.S. soil has the potential to be enormous. It is worth nothing that even with the VCF a substantial number of lawsuits were filed in the wake of 9/11. For example, recent media reports suggest that settlements have been reached in 93 of 96 wrongful death and injury lawsuits related to 9/11 and submitted to Federal District Court in Manhattan. Although the amounts are confidential, reports cite a document showing that the defendants have paid out a total of $500 million.[10]

Ground Zero Workers and Health Claims

In addition to the direct liability costs associated with terrorist attacks, ailments and illnesses contracted by workers involved in post-attack rescue and clean-up activities can increase liability losses by hundreds of millions of

[10] *Judge's Approval Sought in 2 Lawsuits from 9/11*, by Benjamin Weiser, the New York Times, 02/05/2010

dollars. These types of suits will add hundreds of millions of dollars to the final cost of a major terrorist attack.

In March 2010, New York City officials and plaintiffs' lawyers announced a settlement of up to $657.5 million to compensate about 10,000 workers whose health was damaged during the rescue and cleanup at the World Trade Center following the terrorist attack of 9/11. The plaintiffs will be compensated according to the severity of their illnesses and the extent of their exposure to contaminants at the site. Payouts to the plaintiffs will come from a federally financed insurance company called the WTC Captive Insurance Company with approximately $1.1 billion in funds to provide coverage to the city. For the settlement to take effect, at least 95 percent of the plaintiffs must agree to the terms, in which case the payments would total $575 million. If all plaintiffs accept the terms, the settlement will total $657.5 million.

CONCLUSION

The cost of terrorism still looms large in United States history. After nine attack-free years, the $32.5 billion in losses paid out by insurers for the terrorist attack of September 11, 2001, places second in an Insurance Information Institute (I.I.I.) ranking of the most costly U.S. catastrophes – after just Hurricane Katrina (2005) ***(Figure 4)***. Nearly 10 years on, 9/11 also remains the worst terrorist act in terms of fatalities and insured property losses.

With a new decade underway, a number of converging factors point to the fact that terrorism is a reemerging threat. Failure to focus on and prepare for this threat will come at an enormous cost to the millions of individuals and businesses who rely on insurance contracts to offset the overall economic impact of a terrorist attack. For property/casualty insurers, the increasing share of losses that they would have to fund in the event of a major terrorist attack on U.S. soil suggests that now is the time to take stock of their terrorism exposures.

Figure 4
THE TEN MOST COSTLY CATASTROPHES, UNITED STATES (1)

($ millions)

			Insured loss	
Rank	Date	Peril	Dollars when occurred	In 2009 dollars (2)
1	Aug. 2005	Hurricane Katrina	$41,100	$45,148
2	Sep. 2001	World Trade Center, Pentagon terrorist attacks	32,500	39,400 (3)
3	Aug. 1992	Hurricane Andrew	15,500	23,702
4	Jan. 1994	Northridge, CA earthquake	12,500	18,095
5	Sep. 2008	Hurricane Ike	12,500	12,456
6	Oct. 2005	Hurricane Wilma	10,300	11,315
7	Aug. 2004	Hurricane Charley	7,475	8,489
8	Sep. 2004	Hurricane Ivan	7,110	8,075
9	Sep. 1989	Hurricane Hugo	4,195	7,258
10	Sep. 2005	Hurricane Rita	5,627	6,181

(1) Property coverage only, except for Sep. 2001 WTC, Pentagon attacks. Does not include flood damage covered by the federally administered National Flood Insurance Program. As of September 2009.
(2) Adjusted to 2009 dollars by the Insurance Information Institute using the Bureau of Labor Statistics' Inflation Calculator.
(3) Insured loss estimate for Sep. 11 terrorist attack includes property, business interruption, workers comp, aviation hull, liability, event cancellation and life insurance losses.

Source: ISO's Property Claim Services unit (PCS); U.S. Bureau of Labor Statistics.

APPENDIX I:

FAQ: 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). TRIA has been renewed twice, and the current law, known as the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) runs until December 2014. Under the program, owners of commercial property, such as office buildings, factories, shopping malls and apartment buildings, must be offered the opportunity to purchase terrorism coverage.

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 TRIPRA 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 have sought to limit fire coverage resulting from a terrorist attack, because commercial policyholders that choose to reject TRIPRA or other terrorism coverage are effectively paying no premium for the protection offered by fire-following coverage. Currently, there is coverage for fire following an act of terrorism in just five states – California, Maine, Missouri, Oregon and Wisconsin.

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 program, 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)/Terrorism Risk Insurance Program Reauthorization Act (TRIPRA)?

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.

TRIA was extended for another two years in December 2005 and for another seven years to 2014 in December 2007. The new law is known as the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) of 2007.

Specific provisions of the legislation are:

- An event must cause at least $100 million in aggregate property and casualty insurance losses to be certified by the Secretary of the Treasury as an act of terrorism.

- The definition of a certified act of terrorism has been expanded to cover both domestic and foreign acts of terrorism.

- 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 85 percent, while the insurer contributes 15 percent.

- The aggregate insurance industry retention in 2007 is $27.5 billion, up from $25 billion in 2006 and $15 billion in 2005.

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

- Lines originally excluded from the program are: personal lines (auto and home), reinsurance, federal crop, mortgage guaranty, financial guaranty, medical malpractice, flood insurance provided under the NFIP and life & health. Additional lines now excluded are: commercial auto, professional liability except for directors and officers liability, surety, burglary and theft, and farmowners multi-peril insurance.

- The Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) of 2007 – is due to sunset on December 31, 2014.

Does the terrorism risk insurance program affect the availability and price of coverage?

Yes, by sharing potential losses from terrorist attacks between private insurers and the government, the terrorism risk insurance program has brought much needed additional capacity to the terrorism market. Before the program existed, businesses were left with little or no terrorism coverage, but since it came into effect 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 the terrorism risk insurance program has had a stabilizing influence on the market.

Does an insurer have to make terrorism coverage available?

Yes. Under TRIPRA, 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.

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

A business that has not purchased TRIPRA 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.