



TERRORISM REPORT

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The Event That Changed The World Of Insurance

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NEW YORK—The events of Sept. 11 did what previous acts of terror in America had not—brought awareness to the global insurance marketplace that random terrorist acts can and will continue to occur in the United States and just how devastating those acts can be. Where, when and how often the acts will occur is the unknown fear of underwriters around the world.

The losses from this disaster are the largest insured loss in the history of insurance. The reaction from the insurance industry was immediate and far reaching. The insurance world, as a whole, began revising insurance contracts and reinsurance treaty negotiations began anew.

The aviation industry was the first to feel the affects of this reaction. Aviation policies typically exclude war which includes by definition hi-jacking and terrorism. Large commercial insurance buyers purchased war and terrorism coverage separately on aviation policies and typically paid a substantially reduced premium for the risk in North America. Smaller insurance buyers typically had this coverage added at little or no charge for their domestic risk. The war risk coverage contains a seven-day provision that allows insurers to modify the policy terms, conditions and buy back costs for coverage.

Following Sept. 11, policyholders were immediately advised that war and terrorism would henceforth be excluded unless

The Cost of Terror

LONDON—Bad news abounded for the world's reinsurance market place. Estimated insurance losses due to Sept. 11 are overwhelming:

- ✦ Berkshire Hathaway, more than \$2 billion
- ✦ Lloyd's of London, nearly \$2 billion
- ✦ Munich Re, nearly \$2 billion
- ✦ Swiss Re, \$1.8 billion
- ✦ Allianz, nearly \$1 billion.

For Swiss Re, the world's second largest reinsurer, its Sept. 11 pay outs contributed to a loss of \$97.7 million, the first in the company's 130-year history.

Lessons Learnt From The World Trade Center Seminar

HUNTINGTON BEACH—The terrorist attacks on the World Trade Center and Pentagon are considered to be the largest losses that the property and casualty industry has ever witnessed. The loss will span all areas of insurance from property, liability, workers' comp and life insurance. Insurance Skills Center has designed a course that focuses on the insurance issues and risk management successes and failures. During the course, the instructor will review such insurance issues as: aircraft liability; impact on the building owner(s) and tenants relating to direct damage; business interruption for those insured both directly and indirectly affected by the event; workers' comp and life insurance. The seminar will discuss the impact of the terrorist attack on the reinsurance market and the global short- and long-term ramifications. The issue of terrorism and its future availability and approaches to securing will also be reviewed. This course is approved in the following states:

- ✦ California: (CDI #0706) - 4 CE
- ✦ Washington: (251873) - 4 CE
- ✦ Nevada: (PRO-521-20) - 3.5 CE
- ✦ Oregon: (AB-04-066-7061) - 4 CE

It is also dually approved for property/casualty and life/health in California and Oregon. This class can be taught on-site at your agency or company. To find out more about scheduling this class, call Patricia Carlson, CIC, ACSR, CISR, at 818-883-0316. □

purchased at a highly increased charge. At that time, only \$50 million of coverage was available for terrorism. That created a problem for the commercial insurance buyer because the lenders and lessors of commercial aircraft require a minimum of \$100 million of coverage, including war risk and acts of terrorism.

This rush to exclude terrorism spread rapidly to other lines of insurance such as commercial property, inland marine and liability policies as soon as their terms and conditions of coverage allowed. Prior to 2002, very few American policyholders had terrorism exclusions on their policies. Those insureds that had overseas exposures, marine coverage or aviation policies had limitations placed on the policies, depending on the countries the underwriters felt were at risk for war, hi-jack and terrorist losses. Clients could often buy back such limitations or exclusions by endorsement or under separate cover for a price that was dependent upon location of risk.

The reinsurance treaties in effect as of Sept. 11 typically contained terrorism coverage in the domestic ceding insurers' contracts. However, that all changed on Jan. 1, when approximately 70% of the U. S. reinsurance treaties renewed. Most of those treaties renewed with terrorism excluded leaving the primary insurers without protection for terrorism. The majority of the reinsurance treaties that renew on July 1, will in all likelihood remove this protection as well.



Smoke billows out of the top of the World Trade Center. (Jim Sulley/WirePix)

The Bush Administration proposed a three year plan that was a combination of private sector and federal funding which capped the insurance industry's exposure at \$12 billion the first year. The plan was criticized by many in the political arena and is also effectively dead.

The House Committee had several different plans promoted by several Representatives. In November 2001 the House passed a one year plan based on a loan guarantee to the insurance companies. The insurers would pay the first \$1 billion in loss. For losses above that amount, the plan would pay 90% of the losses to be reimbursed by the insurance industry over a period of time.

In 2001, the Senate Banking Committee had several proposals to consider and closed session without acting. The Banking Committee is currently considering various plans. At the April 2002 Legislative Conference of the IIABA, Sen. Christopher Dodd stated he thought the Senate could put a terrorism program together by the end of April. That was found to be quite optimistic. There is some hope that a form of terrorism protection will be in place some time in May 2002.

Insurance regulators across the country are allowing admitted insurers to request filings to exclude terrorism from property, liability, umbrella or excess liability and business auto policies. Workers' compensation, marine and aviation lines are not included. Two notable exceptions are California and New York. A number of states have placed contingencies on the filing requests that relate to the insurers' ability to purchase reinsurance or the federal government enacting legislation providing insurance protection. The admitted carriers

This move by the reinsurers left the primary carriers in an unenviable position. Primary insurance companies are left with two options: (1) they must either retain 100% of the risk and attempt to price the risk, or (2) try to limit or exclude the terrorism exposure in its entirety. The former is hardly an option as there is no possible way to calculate probable maximum loss in light of inadequate historical data and actuarial models on which to base the pricing. The latter option of excluding terrorism is the choice most of the primary insurers are (or will be) taking.

Enter the federal government. On Sept. 21, the U. S. Congress passed a temporary program, providing federal terrorism reinsurance as a backstop of protection to domestic airlines. This temporary program expired in both the U.S. and the U.K. on March 20. President Bush and Congress were advised by insurance representatives that future property and casualty insurance policies would leave many policyholders without coverage for terrorist acts.

The House Financial Services Committee commenced hearings immediately to research the feasibility of the federal government providing terrorism reinsurance that would be paid for by federal tax dollars.

The insurance industry proposed a plan to the House in October 2001. This plan was for a state-chartered mutual insurance company called Homeland Security Mutual Reinsurance. The proposal was to have one coverage pool for personal lines and a separate coverage pool for commercial lines. Participation in either pool was to be voluntary. This would provide reinsurance for all lines of property and casualty, including war risks under workers' compensation statutes. This proposal was not accepted by the House and is effectively dead.

State Executives Implore Treasury To Reconsider Stance With U.S. Patriot Act

ALEXANDRIA, VA—IIABA and state association executives initiated a grassroots effort last week to persuade the Treasury Department to exclude independent agents and insurance brokers from onerous requirements in the Patriot Act's anti-money laundering rules. The USA Patriot Act (Public Law 107-56) was created to stop money laundering by terrorist organizations, but Treasury concluded it was Congress's intent to have all financial institutions, including independent agencies, create new anti-money laundering programs. "Unfortunately, since the programs of this law may include the establishment of a money-laundering program, the designation of a compliance officer for the program, and an annual audit of the program, our members would be forced out of business if they were required to incorporate these measures. I am urging you to not put this huge burden on our independent insurance agents and brokers. Their small business and others within our industry will not be able to absorb the astronomical cost of incorporating the proposed rules and practices," reads the grassroots letter. Recently, the Treasury delayed application of the rules for independent agents and brokers, saying that further study is needed. The efforts of the state executives and the Big "I" are to make these exclusions permanent. The letter concludes: "Very little, if any, money could be laundered through independent insurance agencies. I respectfully request that you not impose these excessive, burdensome requirements on independent insurance agents and brokers." For a copy of the letter, call IIABA's fax-on-demand service at 800-296-0578 and select document number 3092. For more information, contact Maria Berthoud at 800-221-7917 or maria.berthoud@iiba.net.

IIABA Says Agents/Brokers Should Not Be Included In Patriot Act Regulations

ALEXANDRIA, VA—The Independent Insurance Agents & Brokers of America (IIABA) recognized as a step in the right direction a decision by the U.S. Treasury Department to delay application of anti-money laundering rules to independent agents and brokers until it further studies the need and implications, said CEO Robert A. Rusbult. "We applaud Treasury Secretary Paul O'Neill and the Bush Administration for taking IIABA's concerns with the Patriot Act into consideration," said Rusbult. "The regulations applicable to huge corporations would have imposed a tremendous burden on the owners of independent agencies, especially when you consider that independent agencies pose no threat for money laundering due to the nature of the business." Read the full story: <http://www.insurancejournal.com/html/ijweb/breakingnews/national/na0402/na0429021.htm> or the related story: http://member.iiba-west.com/pdf/newsletters/Weekly_Insider/PAct.PDF. □

have options available to them. As a participating insurer of ISO a carrier can use the ISO exclusionary filings. If a member of AAIS, a carrier can use the AAIS filings. Additionally a carrier may look to their own legal department to design their own form language.

Many insureds are receiving notices of non-renewal in the event the insurers are not able to obtain approval of their exclusion in time for renewal. In many cases, this shifts the account to the non-admitted market. Virtually all of the non-admitted carriers have added or are in the process of adding terrorism exclusions using their own wording.

The ISO version of the exclusion (limitation) has been filed for use with commercial property, liability, umbrella, business auto, boiler and machinery and crime policies. The ISO endorsement uses two separate threshold triggers to exclude losses: (1) When the total of all insured property loss exceeds \$25 million or (2) Fifty people sustain death or serious physical injury from an act of war or terrorism. These two thresholds are irrelevant if the act of terrorism involves the use of nuclear or pathogenic or poisonous biological or chemical materials. In that scenario no war or terrorism coverage will apply.

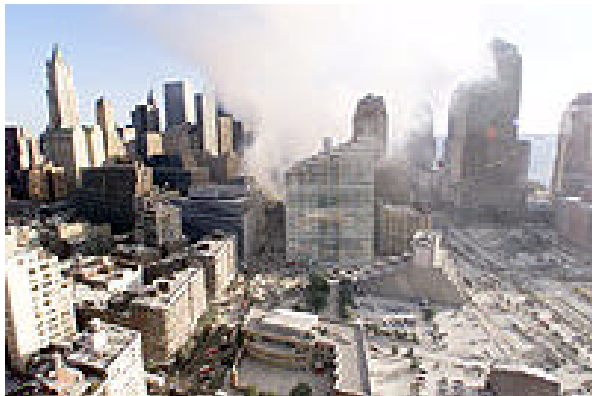
Terrorism is defined in the endorsement as follows: “*Terrorism means activities against persons, organizations or property of any nature: that involve the following or preparation for the following: use or threat of force or violence; or commission or threat of a dangerous act; or commission or threat of an act that interferes with or disrupts an electronic, communication, information, or mechanical system; and when one or both of the following applies: The effect is to intimidate or coerce a government or the civilian population or any segment thereof, **or to disrupt any segment of the economy; or it appears that the intent is to intimidate or coerce a government, or to further political, ideological, religious, social or economic objectives or to express (or express opposition to) a philosophy or ideology.** The endorsement also defines one incident to include multiple events occurring during a 72 hour period and appear to have been carried out in concert or to have a related purpose.*” (Certain words have been put in bold print for emphasis.)

In reviewing the terrorist and war exclusion as written, it would appear that the authors of this language have gone far beyond simply excluding war risk and terrorist acts to excluding any act of terror or violence from the coverage forms. Although using language from the U. S. Code of Federal Regulations, ISO has expanded the definition to the point where the circumstances under which the exclusion would be invoked is unclear.

Part of the concerns that agents, brokers and risk managers are expressing is whether or not the exclusion being used by the insurance company is specific to the issue of terrorism. It is possible out of an overabundance of caution (and legitimate fear of legal interpretation of language and intent) that the endorsement language may go further and exclude such losses as robbery, rioting and acts of destruction by an employee.

As to the impact on the insureds and economy now, during a question and answer session with the House Finance Committee on Feb. 27, Alan Greenspan stated that the issue of terror insurance was not a threat to U.S. banks and that the problem has not affected the economy as a whole. Mr. Greenspan believes that, “Much of the problem is that it is presumed that banks won’t lend unless a particular borrower has forms of insurance which previously they did not need.”

Mr. Greenspan’s comments aside, it appears that this is exactly the case with many banks and many insureds. In April IIABA and AAI released a study verifying the lack of terrorism insurance is, in fact, having a damaging effect on the economy. Large contractors and



World Trade Center collapses. (Robin Weiner/WirePix)

developers are reporting that funding is not available on projects unless they can verify terrorism coverage has been provided. Many real estate agents are reporting that some of their real estate transactions are not being funded and/or are being cancelled due to the lack of available or affordable terrorism insurance. Lenders are requiring owners of commercial buildings to verify terrorism coverage is in place on their collateralized property. As an example, the Simon Property Group, owners of the Mall of America, went to court recently in Minneapolis and obtained a restraining order prohibiting GMAC Commercial Mortgage Corp. from purchasing terrorism insurance on the Mall of America and passing the cost of that coverage to the owners.

Terrorism insurance has become more “available” in the intervening months since Sept. 11, but that is a relative term. Insurers such as AIG, ACE, Lloyds and Berkshire Hathaway have offered various types and amounts of terrorism coverage, but the cost is prohibitively high for “target risks,” even for the largest insureds. Coverage limits up to \$500 million appear to be readily available, providing the insured can bear the cost. The insurers are also limiting their risk exposure per location and this is often not enough to cover the clients’ needs or satisfy their lenders.

By definition, terrorist acts are unpredictable in nature and have wide-spread impact across all lines of insurance and risk. With every government announcement of a terrorist threat, even without another devastating act, the insurance world withdraws further and further away from providing a risk transfer solution, except for very specialized markets. By the same token, the very real financial exposure for uninsured losses that insureds face is such that should another event of the same nature or worse occur, it could leave a tattered economy in its wake.

The question seems to be whether or not the standard insurance marketplace is the appropriate venue for this risk exposure. The various hurdles of regulatory issues, financial and investment concerns, and actuarial models that have yet to be formed seem to be overwhelming. This is particularly true in the hard market that is plagued with so many other concerns for its stability and financial recovery.

It appears, at least for now, that the insurance industry's reaction to terrorism has left a gaping hole of uninsured risk with very limited coverage solutions. A long term solution from the insurance industry is not yet at hand and may never come. In the short term, the only apparent immediate solution will have to come from the federal government assigning our tax dollars as a society to aid those in need. Let us hope that the need for federal intervention will be very short term, indeed.

Sources used:

- ⊕ Insurance Information Institute
- ⊕ Associated Press
- ⊕ Reuters
- ⊕ Independent Insurance Agents & Brokers of America
- ⊕ *Insurance Journal*
- ⊕ *Business Insurance*
- ⊕ *Wall Street Journal*

War On Terror Carries Compliance Duties For Insurers

WASHINGTON—Insurers have new compliance responsibilities under the USA PATRIOT Act, the federal anti-terrorism legislation passed last fall in the wake of the Sept. 11 attacks. Insurers are considered to be “financial institutions” under money laundering regulations, and were originally required to have a money-laundering detection program in place by April 24. The U.S. Treasury has postponed the date for compliance, however. To see key sections of the law being cited by insurance commissioners: go to <http://thomas.loc.gov>; enter “HR 3162” for bill number; click on Sec. 326 regarding verification of customer identity; then click on Sec. 352 regarding money laundering compliance programs.

Buffet Says Future Attacks Could Ruin Insurers

OMAHA, NE—Predicting future terrorist attacks larger in size and scope than those on Sept. 11, Warren Buffet warned this week that many insurance companies are “exposed to ruin” from policies including terrorism coverage. Buffet made his comments during the annual meeting of his company, Berkshire Hathaway. “It’ll happen—in the next 10 minutes or the next 50 years,” said Buffet indicating the risks of such an attack aren’t quantifiable. The terrorist attack of Sept. 11 was the most expensive loss in the history of the insurance industry. Over 100 insurers around the globe are expected to pay an estimated \$40 billion or more dollars in the course of settling tens of thousands of claims—Berkshire Hathaway is expected to pay out \$2.4 billion of that. “Warren Buffet, a true expert on the issue of reinsurance, has made it crystal clear why we need some type of federal backstop against future terrorist attacks,” said Maria Bethoud, vice president of federal government affairs at the Independent Insurance Agents and Brokers of America (IIABA). “While the industry covered all claims with Sept. 11, the insurance industry will not be able to absorb such a loss again, and I believe that anyone who does not believe that another attack will come at some point is being unrealistic. IIABA believes we need to be looking to the future stability of the insurance industry so our country is able to function properly in any type of scenario.” During last month’s IIABA National Legislative Conference, Senate leaders Michael G. Oxley (R-OH) and Chris Dodd (D-CT) called on the Senate to pass a federal terrorism insurance backstop. Oxley called the lack of terrorism insurance a drag on the economy saying, “That’s the last thing we need as we struggle out of a recession. This is becoming more than an insurance issue, it’s becoming an economic issue.” The U.S. House of Representatives passed legislation related to a federal terrorism insurance backstop in November 2001. Buffet also called for insurance regulators to allow exclusions in policies for damage from nuclear attacks.



Smoke continues to fill the sky from the collapsed World Trade Center. (Robin Weiner/WirePix)

Oregon Insurance Division Releases “Patriot” Bulletin

PORTLAND, OR—The Oregon Division of Insurance recently issued a bulletin regarding obligations for financial institutions under the Patriot Act, signed into law last October by President George W. Bush. This law, enacted in response to the terrorist attacks of Sept. 11, aims at combating terrorism and preventing and detecting money-laundering activities. Section 352 of the Act amends the Bank Secrecy Act (BSA) to require that all financial institutions establish an anti-money laundering program, and Section 326 amends the BSA to require the Secretary of the Treasury to adopt minimum standards for financial institutions regarding the identity of customers that open accounts. So far, insurance brokers and agents are not required to comply with the provisions—pending an extended review period. House Financial Services Committee Chairman Mike Oxley (R-OH) recently wrote in a letter to treasury Secretary Paul O’Neill that, “We need to ensure that the burdens we are imposing on low-risk financial institutions do not outweigh the gains. There has been little evidence of money laundering being conducted through insurance products. It would be particularly difficult to launder money through property/casualty products, or life products without cash value. The commensurate requirements placed on underwriters and agents of these products should be correspondingly less.” Read more: <http://www.cbs.state.or.us/external/ins/docs/bulletins/bulletin2002-03.htm>.

Terrorism And Insurance Seminar—Global, Historical And Current Perspective

HUNTINGTON BEACH—Insurance Skills Center recently filed a new seminar on “Terrorism and Insurance” with the Departments of Insurance in CA, NV, OR and WA for 4 CE credits. The course provides an historical overview of the global development of insurance for terrorism and war risks, policy language analysis, review of new exclusions, and risk management concepts. To schedule this class in your office or agency, call Patricia Carlson at 818-883-0316. □