Commentary

Terrorism Coverage:

What Every Corporate Policyholder Needs To Know

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I. Introduction

Prior to September 11th insurers neither priced for nor reserved for losses from terrorism. Terrorism was not identified as a separate peril in insurance policies, nor was any significant premium charged for terrorism risk. Terrorism was simply not considered a significant peril in the rating and underwriting of insurance in the United States.

The September 11th attacks changed insurance in the United States. Since September 11th, terrorism exclusions have been added to property and general liability policies. Rates in the property and casualty market have risen anywhere from 30% to 300%, with the average rate increase being approximately 50%. Attachment points for excess programs have also risen, which makes the rates that much costlier considering that less coverage is provided. *See* Zolkos and Hofmann, *Property Market Sees Rate Hikes, Diminished Capacity*, BUS. INSURANCE, July 8, 2002.

This article will discuss the problems policyholders experienced in trying to obtain insurance coverage post September 11th. The article will also discuss the federal terrorism legislation and the impact of the legislation on the insurance market.

II. The Insurance Industry Response To September 11th — A Historical Background

At one time, terrorism was covered by most reinsurance contracts — primarily because it wasn't specifically excluded. Most major reinsurers, which operate on a global scale and face much less regulation than domestic insurers, notified domestic insurers soon after September 11th that they would drop terrorism coverage when policies came up for renewal. For those reinsurers not excluding terrorism coverage, the offered terrorism coverage was subject to a certain sub-limit that was substantially less than the limit for other perils.[1]

With reinsurers announcing the imposition of new terrorism exclusions as a condition of coverage, domestic insurers, faced with an inability to spread the risk of terrorist attacks through the worldwide reinsurance market, sought relief on two alternative fronts: governmental action to fill the void left by the reinsurers; and policy language excluding injury and damage caused by

acts of terrorism. *See* Woodward, *The ISO Terrorism Exclusions: Background and Analysis*, INTERNATIONAL RISK MANAGEMENT INSTITUTE, INC., February 2002.

In November 2001, Insurance Services Office (ISO) filed an initial terrorism exclusion form. ISO's approach was to replace the war exclusion, as it existed in different forms in commercial property and CGL coverage forms, with new exclusions pertaining to both war and "terrorism." As for property coverage, the proposed exclusion applied to:

> loss or damage caused directly or indirectly by terrorism, including action in hindering or defending against an actual or expected incident of terrorism. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.

Id.

With respect to general liability coverage, the exclusion applied to bodily injury, property damage, and personal and advertising injury:

> arising, directly or indirectly, out of "terrorism," including any action taken in hindering or defending against an actual or expected incident of "terrorism" regardless of any other cause or event that contributes concurrently or in any sequence to the injury or damage.

Id. Both the property and general liability submissions defined "terrorism" as:

> "Terrorism" means activities against persons, organizations or property of any nature:
>
> 1. That involve the following or preparation for the following:
>   a. Use or threat of force or violence;
>   b. Commission or threat of a dangerous act; or
>   c. Commission or threat of an act that interferes with or disrupts an electronic communication, information, or mechanical system; and
> 2. When one or both of the following applies:
>   a. The effect is to intimidate or coerce a government, or to cause chaos among the civilian population or any segment thereof, or to disrupt any segment of the economy; or
>   b. It is reasonable to believe the intent is to intimidate or coerce a government, or to seek revenge or retaliate, or to further political, ideological, religious, social or economic objectives or to express (or express opposition to) a philosophy or ideology.

Id. Despite the ISO efforts, a number of insurers drafted their own more restrictive terrorism exclusions.[2] A few examples include:

> 1. This policy does not insure against any loss, damage, cost, or expense caused by or resulting from any of the following, regardless of any cause or event contributing concurrently or in any other sequence thereto . . . any act or threatened act, by any person or persons, arising from or related to any attempt to overthrow, coerce, intimidate or establish any government or sovereign power (de jure or de facto) or to intimidate or coerce a civilian

population or any segment thereof, or to inflict economic loss, property damage or personal injury, in furtherance of any political, religious, financial or ideological objectives.

2. This insurance does not cover any loss or damage occasioned by or through or in consequence, directly or indirectly, of any of the following occurrences, namely . . . any act of terrorism committed by a person or persons acting on behalf of or in connection with any organization. For the purpose of this condition, "terrorism" means the use of violence for political ends and includes any use of violence for the purpose of putting the public or any section of the public in fear.

3. This policy does not cover . . . any act, including but not limited to the use of force or violence and/or the threat thereof, of any person or groups of persons, whether acting alone or on behalf of or in connection with any organization or government, committed for political, religious, ideological or similar purposes, including the intention to influence any government and/or to put the public, or any section of the public, in fear. In any action, suit or other proceeding where the Insurer alleges that by reason of any provision of this exclusion any loss or damage is not covered by this insurance, the burden of proving that such loss is covered shall be upon the Insured.

Id.

As it became more and more apparent through December 2001 that Congress would not approve terrorism coverage legislation, state insurance departments began examining the proposed ISO exclusions and found them to be overly broad. As a result, in consultation with state regulators, ISO revised its original terrorism filing. *Id.*

The ISO revisions included the imposition of quantitative thresholds for triggering the exclusion — a property damage threshold and a bodily injury threshold. The thresholds were designed to make the terrorism exclusion applicable only when the terrorist act caused catastrophic injury or damage. The property damage threshold was set at $25 million and included both direct damage and business interruption.[3] The bodily injury threshold was triggered when 50 or more persons were killed or seriously injured. The terrorism exclusion would apply when either one or both of the thresholds were met. If triggered, it would apply to all injury and damage caused by the terrorism, both below and above the threshold. *Id.*

In the revised terrorism exclusion, ISO defined what constituted a single "terrorism incident":

> Multiple incidents of "terrorism" which occur within a seventy-two hour period and appear to be carried out in concert or to have a related purpose or common leadership shall be considered to be one incident.

In addition, ISO revised the definition of "terrorism" to delete language that could cause argument or that resulted in a subjective application. Further, as a result of the anthrax scare and the growing fears that known terrorist groups might have or be seeking control of nuclear weapons, additional language regarding terrorism that involved the use of nuclear, chemical, or biological weapons were added to the exclusion. *Id.*

Forty-five out of fifty state insurance departments approved the revised terrorism exclusions. They were technically not just "terrorism" exclusions. In property policies, the endorsement was entitled "Exclusions of War, Military Action and Terrorism." The endorsement in CGL policies was entitled "War or Terrorism Exclusion." Both endorsements combined a terrorism exclusion

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with the standard war and military action exclusion already found in commercial property policies. *Id.*

The effect of the terrorism exclusion under a standard commercial property policy was limited to terrorism claims (since the war exclusion was the same as the one already applicable to the same policy). For some property lines (e.g., commercial crime), the endorsement imposed a broader war exclusion as well as imposed a new terrorism exclusion. *Id.*

With respect to occurrences that meet the definition of "terrorism" in the exclusion, the result was there would be no coverage for damage to insured property:

- When nuclear materials were used in the terrorist act
- When the terrorist act consisted of the "dispersal or application" of chemical or biological weapons (chemicals or biological materials that are poisonous or cause disease)
- When poisonous or disease-causing chemicals or biological materials were released by a terrorist act in such a way that it appeared the release was one purpose of the act

Id.[4] For those terrorist acts that did not fall into one of the above categories (non-nuclear, non-chemical, non-biological), the exclusion in property policies was triggered when the total insured damage exceeded $25 million.[5] *Id.* Damaged property must have been located in the United States, Puerto Rico, and Canada. The $25 million threshold applied to all related terrorist acts within a 72-hour period and to all damage resulting from the terrorist act. *Id.*

There were two ways the ISO terrorism exclusion applied to property coverage: (1) it imposed the exclusion completely, without regard to the type and scope of the property damage; or (2) it made an exception for direct loss or damage by fire. With respect to the exception for direct loss or damage by fire, the law in certain jurisdictions requires this exception because property coverage may not be more restrictive than the provisions of the standard fire policy (SFP).[6] The exception that applies in the SFP jurisdictions applies only to direct fire damage and not to any consequential loss caused by fire. *Id.* In non-SFP states, the terrorism exclusion applies to property losses without exception, including terrorist acts that cause direct damage from fire. *Id.*

STANDARD FIRE POLICY (SFP) AND NON-SFP JURISDICTIONS

SFP STATES	NON-SFP STATES
Arizona	Arkansas
California	Colorado
Connecticut	Delaware
Georgia	District of Columbia
Hawaii	Florida
Idaho	Indiana
Illinois	Kansas
Iowa	Kentucky
Louisiana	Maryland
Maine	Mississippi
Massachusetts	Montana
Michigan	Nevada

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Minnesota	New Mexico
Missouri	Ohio
Nebraska	Puerto Rico
New Hampshire	South Carolina
New Jersey	South Dakota
New York	Tennessee
North Carolina	Utah
North Dakota	Vermont
Oklahoma	Wyoming
Oregon	
Pennsylvania	
Rhode Island	
Texas	
Virginia	
Washington	
West Virginia	
Wisconsin	

As for CGL policies, the ISO "war or terrorism" exclusion significantly changed the basic coverage. The war exclusion that was already contained within the policy applied only to liability under a contract. The "war" part of the new ISO endorsement, however, imposed a broad exclusion of liability arising out of war and any "warlike action," including defensive and preventive governmental actions. *Id.* While the terrorism part of the exclusion (the actual exclusionary language and the definition of "terrorism") was the same as the property insurance version, there were two differences. First, the $25 million property damage threshold in the CGL policies applied to property damage anywhere in the world, arising out of one terrorism "incident." *Id.* The property damage threshold in property policies was limited to the United States and Canada. Second, because liability claims may involve either property damage or bodily injury, a "serious physical injury" component was added to trigger the policy. Under the new wording, the exclusion applied to liability claims when a terrorist incident caused either $25 million of insured property damage or the death of or serious physical injury to 50 people. Like the property exclusion, the threshold was inapplicable to terrorist incidents involving nuclear, biological, or chemical weapons. Liability stemming from terrorism using any of these weapons was excluded. *Id.*

As previously stated, forty-five states, the District of Columbia, Puerto Rico, and Guam approved the ISO filings. In each of those jurisdictions, regulatory approval was granted with an effective date of January 1, 2002, except for Alaska, where the effective date was January 12. While ISO expected approval in three additional states — Florida, Georgia, and Texas — two states — California and New York — refused to approve the filings and were pursuing discussions with ISO about possible further amendments.[7] *Id.*

III. Problems Finding Coverage — What Was Available

After September 11th, commercial insurance buyers looking for terrorism coverage basically had three choices — they could buy expensive stand-alone policies (if they could find any), they could set aside funds and self-insure their exposure, or they could go bare and hope for the best.

Eighty percent of the insurance market excluded terrorism from commercial policies. See Widmer, *Terrorism Insurance: Where's the Coverage?* RISK & INSURANCE, July 2002, at 12). In 2002 *Risk and Insurance* conducted a search for terrorism coverage in all industries and found that only nine companies were providing first-party stand-alone coverage. (See chart attached). Other companies provided some level of terrorism coverage under third-party policies within specialty lines, such as the Nuclear Electric Insurance Limited's coverage for nuclear power plant property damage, and Oil Insurance Limited's petroleum industry product. AEGIS offered terrorism coverage for utility companies and to members. The Air Transportation Association created a terrorism insurance product that they distributed through Equitime, their captive insurer creation.

Stand-alone terrorism markets existed, including Lexington, AIG and London entities. These insurance carriers provided tailored coverage that responded to specific exposures, rather than global policies in which specific exposures were not recognized and priced. In addition, these carriers were very selective about who they underwrote since they were only underwriting a limited number of risks and had only a limited capacity to write terrorism coverage. *Id.*

As treasurers and risk managers discovered, stand-alone terrorism coverage cost as much as all other forms of property insurance combined. Before September 11th, a $100 million property policy (that included terrorism coverage) might cost as little as $200,000. After September 11th, the same policy cost anywhere from $400,000 to $600,000 — and excluded terrorism risks. To get an added $25 million of terrorism coverage, a policyholder might have had to pay an additional $500,000.

Property damage deductibles ranged from $5000 to $50 million. AIG reported that in most cases the deductible was 2 percent of the total insured value at each location involved in a loss, subject to a minimum deductible of $25,000. There was a thirty-day waiting period for business interruption, which was tantamount to no coverage for many. Lloyd's of London's deductible range was $50,000 to $50 million. The average deductible was $25 million. It too imposed a thirty-day wait for business interruption. Betterley, *The Terrorism Coverage Market: Hope for Coverage in a Difficult Market*, THE BETTERLEY REPORT, April 2002, at 3-4.

IV. Impact Of September 11th Is Widespread

Commercial Real Estate

With major hikes in general liability, property, casualty, and terrorism insurance premiums, commercial property owners saw a decline in their potential net operating income; and the appeal of commercial real estate investments dwindled. Though insurance was still available, premium boosts as high as 300 percent gave owners no choice but to pass the costs on to tenants. The Mortgage Bankers Association of America stated that more than $10 billion in commercial transactions were scrapped, delayed, or altered due to soaring insurance costs. *See* Freedman, *Survey: Lack of Terrorism Coverage Thwarts $10.5 Billion in Real Estate Deals*, NATIONAL REAL ESTATE INVESTOR, October 2002 at 17.

Workers Compensation

The aggregation of risk at the World Trade Center made workers' compensation one of the insurance lines hit hardest by the September 11th attacks. Insured losses for workers' compensation ranged from $1.3 billion to $4 billion. Terrorism coverage left workers' compensation insurers in a tough position because insurers were not permitted to increase rates just for terrorism coverage. State laws, moreover, mandated that terrorism be covered under workers' compensation policies. Because reinsurance companies excluded terrorism, some insurers looked for ways to reduce their concentration of risk or reduce coverage in some regions. As a result, several policyholders, particularly in large metropolitan cities, reportedly had a difficult time finding afford-

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able coverage. *See* Pilla, Gorski, Green, Kelly, Noonan and Suszynski, *One Year Later*, BEST'S REVIEW, September 2002, at 41.

Transportation Industry

The September 11 tragedy hit hardest among airlines and airports, in terms of insurability as well as business losses. These two transportation segments were already losing revenue when the U.S. government closed airports and grounded planes for several days after the attacks. This was followed by a dramatic falloff in business because of the public's reluctance to fly. Airlines and airports suffered another blow when insurers quickly canceled their third-party war and terrorism coverage.

Commercial trucking faced an additional challenge as terrorism became an underwriting issue. Insurance rates had increased since 2001. With the risk of terrorism came new issues, including exposure not just to the theft of cargo, but also to potential liability if it was used as a weapon. Zolkos, *9/11 Changed Rules of the Road*, BUSINESS INSURANCE, May 2002, at 19.

Mortgage Bankers

Moody's Investors Service downgraded $4.5 billion in commercial mortgage-backed securities ("CMBS") because owners of some high-profile skyscrapers were not able to buy terrorism insurance, and Congress hadn't passed a bill to provide a government-backed plan. The downgrade cast a cloud over the ratings of future CMBS issues. Since September 11, 2001, issuers have reacted by moving trophy properties that might have backed a securities issue alone into larger pools containing many properties, lessening, but not eliminating the risk.

Other evidence of problems caused specifically by the uncertainties surrounding terrorism insurance included: (a) premium increases for policies of 40 to 300 percent; (b) declining loan commitment and origination levels caused by expanded due diligence and time commitments necessary to evaluate insurance policies; (c) lenders' utilization of stricter underwriting guidelines that were reflective of the increased risk associated with insurance policies, and reducing property income available to service debt; and (d) mortgage holders of properties requiring that the owners of properties buy terrorism insurance or be in breach of the mortgage contract.[8] *See*, *MBA Issue Paper: Uncertainty of Terrorism Coverage for Commercial Real Estate Properties*, MORTGAGE BANKERS ASSOCIATION OF AMERICA, July 2002.

Utilities

Many U.S. utilities had difficulty obtaining terrorism insurance for power plants, generators and substations, creating a potentially huge financial risk. Some utility companies pieced together coverage from several insurers, but it was not easy. Some utility companies elected not to insure their properties because of the cost. The Sacramento Municipal Utility District in California was one. Associated Electric & Gas Insurance Services (AEGIS), a mutual insurance company for the utility and energy industry, provided limited terrorism coverage, but its reinsurance restricted it to offering just $50 million in terrorism insurance. Even then, the coverage was capped for the entire utility industry at $100 million. *See*, Spinner, *Lack of Terrorism Insurance Puts Utilities at Risk*, WASHINGTON POST, Thursday, Aug.1, 2002.

Construction Industry

An inability to obtain terrorism insurance coverage on new construction projects was another developing crisis. Terrorism coverage was available for some projects, but it was limited and expensive. Construction of any high-rise building made terrorism insurance coverage difficult to obtain. Zolkos, *Terror Risk Hits New Construction*, BUSINESS INSURANCE, Feb. 18, 2002.

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Municipalities

The town of Tulelake, California temporarily ceased offering public services because it was unable to renew its liability coverage. This was due to the fact that its insurer could not get approval for a terrorism exclusion — California being one of a handful of states that did not permit terrorism insurance exclusions. Eventually, an insurance pool with other local governments allowed city services to resume.

Pollution Claims

Policyholders looking to purchase insurance coverage for pollution liabilities caused by acts of terrorism were more successful obtaining affordable coverage for this risk than for the risk of property damage from such attacks. Like commercial property policies, primary pollution liability policies were renewed with exclusions for terrorism and bio-terrorism risks. In the marketplace for primary pollution policies — unlike in the property marketplace, where terrorism capacity had dried up and what coverage was available was exorbitantly expensive — a policyholder could purchase terrorism coverage on a buyback basis or as an endorsement for a reasonable price. For companies not considered terrorist targets, most underwriters were willing to completely eliminate the exclusion from the policies. Coverage for a terrorist or bio-terrorist attack would be triggered under a pollution liability policy only if the attack were to cause an environmental incident that, in turn, caused liability to the policyholder. In general, policies covered onsite and offsite cleanup third-party bodily injury and property damage. Up to $200 million in limits were available in the marketplace, but $50 million was the norm. When terrorism coverage was purchased on a buyback basis, there was often a lower sub-limit imposed for an additional premium of between 10% and 30%. Chubb, for instance, offered terrorism coverage on a buyback basis subject to a sub-limit of about $20 million to $25 million. Most concerned about the terrorism exclusions were water treatment facilities, property management owners, power plants and chemical handling facilities. Roberts, "*Terror Cover Not Lacking for Pollution Risk*, BUSINESS INSURANCE, June 17, 2002.

Cyber-terrorism Claims

Cyber-terrorism is another threat. Cyber-terrorism is different from the typical computer virus that strikes homes and businesses. Cyber-terror attacks are politically motivated and are designed to cause destruction to a country's infrastructure (financial institutions, power companies, hospitals and manufacturers). Goch, *Demands for Coverage Increase as Cyber-Terrorism Risk is Realized*, BEST'S REVIEW, at 59. The Center for Strategic & International Studies reported that almost all of the Fortune 500 companies' technological infrastructures have been hacked into by cyber-terrorists. The Center also revealed that it would take fewer than 30 computer hackers strategically placed around the world with a budget of less than $10 million to decimate the technological infrastructure of the U.S. economy. *Id.* Insurers and brokers like AIG, Chubb and Marsh offer cyber-terrorism coverage.

V. Federal Terrorism Legislation

In October 2002, Congressional committees reached a compromise agreement on the terrorism insurance bill. The deal came after the Bush administration backed off from its demand that sweeping tort reforms be included in the legislative package. Congressional Democrats also made concessions, under which multiple lawsuits for property loss, personal injury or death from terrorist would be consolidated in a federal district court. These lawsuits would have no monetary limits on punitive damages, though. *See* Hofmann and Geisel, *Terror Cover Deal Reached,* BUSINESS INSURANCE, October 21, 2002. The House of Representatives approved the federal backstop measure on a voice vote the week of November 11th. The Senate approved the legislation during the week of November 18th. President Bush signed the bill, called the Terrorism Risk Insurance Act, on November 26, 2002.

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The legislation establishes a program within the Department of the Treasury under which the federal government shares the risk of loss from future terrorist attacks with the insurance industry. The law is triggered when the Treasury Secretary and the Secretary of State, with the concurrence of the Attorney General, certify[9] that an act meets the definition of "terrorism." *Id*. at 52. An act of "terrorism" is one that causes damage of at least $5 million in the United States and is committed by persons acting for foreign interests.[10] Domestically sponsored terrorism is excluded. Acts of war are covered for workers compensation claims only.

Under the legislation, all insurers — direct, surplus lines, and alien — that write primary and/or excess property/casualty insurance for U.S. risks will be required to participate in the program; make coverage available for terrorism losses in all of their property/casualty coverages; and offer coverage in a manner that does not differ materially regarding terms, amounts or other limitations of coverage offered for acts other than terrorism.[11] When offered, the terrorism coverage premium and the existence of the federal backstop must be clearly and conspicuously disclosed to policyholders.[12] Insurers that use the NAIC model disclosure forms are in compliance with the Act's requirement that they disclose to policyholders the availability of terrorism coverage. *See Treasury Department Interim Guidelines, December 3, 2002.*

Under the legislation each participating insurance company is responsible for paying a deductible before federal assistance is available. The deductible is based on a percentage of direct premiums written from the previous calendar year. The deductible schedule for insurers through January 1, 2003 is 1% of the premiums an insurer earned from lines covered by the act over 12 months. The deductible rises to 7% for claims in 2003, 10% for claims in 2004 and 15% for claims in 2005. *Id.* Once the deductible is reached, the government will cover 90% of the losses and the insurer will cover 10%. Losses covered by the federal program will be capped at $100 billion.[13] Insurers that have met their deductibles are not liable for any portion of the amount of insured losses that exceed $100 billion. For amounts over $100 billion, it will be up to Congress to determine the source and method of any payment. The government can recover[14] its payments below a fixed amount on an industry-wide basis — $10 billion in the first year, $12.5 billion in the second year and $15 billion in the third year — through a surcharge, up to 3% of premiums, on policyholders. *Id.*

Now that the legislation has been signed into law, all existing terrorism exclusions in policies are voided and insureds are covered for terrorism. Insureds automatically have terrorism coverage during the period of time it takes for insurers to issue notices of premium increases for the coverage to the insureds (90 day limit) and for the insured then to consider those increases and respond (within 30 days of receipt of the notices). The terrorism coverage will be eliminated in a policy if the insured agrees to an exclusion or fails to pay an increased premium charge for the coverage. *See* Hayes, *Highlights of Terrorism Bill Provisions*, NATIONAL UNDERWRITER, November 25, 2002, at 6.

There are no restrictions or federal regulations for the rates to be charged for terrorism insurance. States are required to allow rate and form changes to take place immediately. However, states retain full authority to disapprove any rates as excessive, inadequate or unfairly discriminatory or reject any forms that violate state law. *Id.* Insurers that fail to comply with the bill's requirements may be fined up to $1 million for a violation. *Id.*

Municipalities and private insurance buyers involved in self-insurance arrangements may participate in the program at the discretion of the secretary. While the program is designed to last three years, the third year is at the discretion of the treasury secretary. As for group life insurance, the secretary is required to issue a report to Congress on availability. Based on this report, the secretary has discretion to allow group life to participate. *See* Brostnoff, *Last Second Changes Sought In Compromise Terrorism Bill*, NATIONAL UNDERWRITER, Steven Brostoff, October 28, 2002, at 5.

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On the hotly contested tort liability issue, the legislation focused on procedural reforms. The legislation created an exclusive federal cause of action for all lawsuits involving property loss, personal injury or death arising from a terrorist event. All the claims will be consolidated into a single federal district court. However, the claims will be adjudicated based on the tort law of the state where a terrorist event occurs. The legislation is largely silent on punitive damages, meaning that the punitive damage standards of the state where an event occurs will apply in any lawsuit. *Id.*

Conclusion

Since passage of the Act, the five states that refused to join the NAIC initiative to standardize terrorism exclusions prior to passage of the Act have expressed concerns about the Act. New York has advised that it has not approved terrorism exclusions, in-force policies are considered to be providing full terrorism coverage and no additional premium can be charged. Terrorism coverage may be excluded if agreed by the Insured. Florida continues to ban terrorism exclusions for admitted insurers. The positions of Georgia, California and Texas are unclear.

Pricing of terrorism coverage has turned out to be a significant problem. Some prices are as low as 2% while others are as high as 150%. Because there is no historical data for rating agencies to come up with prospective loss-costs, some insurers are using a risk assessment protocol to determine rates. These protocols take into account the location of a property risk, its particular operation and whether more than one client is on the premises. ISO conducted a study that placed Washington D.C., New York, Chicago and San Francisco in the highest of three risk tiers. A second tier consists of LA, Houston, Philadelphia, Boston and Seattle. The rest of the country is in tier three. ISO rated the first-tier cities 100 times riskier than the rest of the country and the second-tier cities 10 times riskier. As a result of the ISO study, some insurers have proposed 150% rate increases for Washington D.C. as a prime target for terrorist attacks.

It was widely hoped that the enactment of the terrorism insurance bill would result in an increase in capacity in the marketplace for terrorism insurance coverage, reduce rates and stimulate the economy. Questions remain as to whether the bill will succeed in doing that. While risk managers, insurers and much of the business community supported the bill, it is unclear whether the bill will actually result in restored coverage for millions of businesses that have otherwise been unable to obtain coverage for terrorist acts.

ENDNOTES

1. The reinsurance process significantly changed after September 11th. Reinsurers began writing more contracts on a non-proportional basis, rather than on a proportional basis, in an effort to limit their liabilities. In addition, reinsurers reviewed their policy wordings to remove unlimited coverage and to provide only named-peril coverage. The most dramatic change was that reinsurers began scrutinizing their accumulation of risk, both on a geographic basis and by individual lines. Reinsurers asked for more details from primary writers to paint the big picture of their total risks. For instance, they wanted to know how close their covered buildings were to landmarks; they wanted head counts of employees in specific offices; and they wanted to know if risks from their large national accounts, and small and midsize accounts, were clustered. *See* Betterly, *Terrorism Coverage Report: Hope for Coverage in a Difficult Market*, THE BETTERLEY REPORT, April 2002, at 3.

2. Small to mid-size insureds purchasing insurance since September 11th likely have ISO-based policies with the ISO terrorism exclusion. Larger insureds, which purchased policies that do not include ISO language, may or may not have terrorism coverage in their policies. Most car-

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riers eliminated terrorism coverage as a cause of loss, although some carriers like FM Global provided a minimal amount of terrorism coverage (e.g., $5 million annual aggregate coverage for losses arising out of terrorist acts).

3. The $25 million property damage threshold was applicable only to insured damage.

4. The difference between the second and third bullet points is that the second bullet point addresses a terrorist act that involves the direct release of a chemical or biological agent (such as the mailing of anthrax-contaminated letters). The third bullet point addresses the use of non-chemical, non-biological terrorist acts that cause a release. Terrorism under either of these conditions, or when there are nuclear materials, is excluded. If any other scenario involves a biological or chemical agent release (for instance, if it appears that the release was an unintended consequence of other terrorist acts) the exclusion applies only when a property damage threshold is met. *Id.*

5. Keep in mind that when applying this threshold, all insured property damage under all policies written by all insurers for all insureds was totaled. Thus, the exclusion was applicable to an insured with far less than $25 million in insured property. *Id.*

6. Standard fire policies insure direct loss by fire regardless of the cause of the fire.

7. The California Insurance Department cited the following reasons for its refusal: (1) the bodily injury and property damage thresholds were unreasonably low; (2) the 72-hour definition of a single "incident" was unfair; (3) the total exclusion of terrorism involving biological or chemical agents (without any threshold) was overly broad; and (4) the exclusion had an anti-competitive effect. The New York Insurance Department also voiced an objection that the $25 million threshold was too low. *Id.*

8. In Four Times Square v. La Salle Bank, et. al, the mortgage requires all-risk property insurance and any other insurance "reasonably requested" by the mortgage holder for risks "customarily insured against" and "generally available . . . at commercially reasonable premiums." Four Times argued that its mortgage did not require terrorism insurance. New York State Supreme Court Justice Harold Tompkins ruled that it did. His decision was stayed, temporarily, pending an appeal.

9. It is important to keep in mind that the terrorist act must be certified. If a terrorist act occurs, but it is not "certified" by the Treasury Secretary, Secretary of State and the Attorney General, the terrorism exclusion in a policy may apply. After passage of the Act, ISO filed new policy forms and rules for insurers to meet the terrorism coverage requirement. The new ISO forms contain standardized policy language for underwriting terrorism coverage in existing policies as well as new and renewal policies. The forms have been filed in two forms: (1) one form for those losses from certified acts of terrorism; and (2) one form that excludes coverage for various acts of terrorism that fall outside the Act's definition of terrorism.

10. An "act of terrorism" is defined as an act certified by the Secretary of the Treasury in concurrence with the Secretary of State and the Attorney General to (1) have resulted in damage within the United States (or outside the United States in the case of U.S. airliners or ships); (2) have been committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of any effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government; and (3) have resulted in property and casualty insurance losses in excess of $5 million.

11. The Act broadly defines "Insurer" to include licensed insurers, non-licensed insurers, surplus line carriers listed on the Quarterly Listing of Alien Insurers of the NAIC, insurers approved to offer commercial or casualty insurance by a federal agency that regulates maritime, energy or aviation activity, a state residual market insurance entity or a state WC fund, any insurer that meets reasonable criteria set forth by the Treasury Secretary, and any other insurer that receives premiums for commercial property or casualty insurance coverage. As a result of an interim

guidance issued by the Treasury Department on 12/18/02, any captive or risk retention group that (1) is licensed by any state; (2) writes qualifying property or casualty coverage on a direct basis; and (3) reports direct earned premium to such state is subject to the Act.

12. Pursuant to the January 22, 2003 Interim Guidelines, the Treasury Department deems an insurer to be in compliance with the separate line item requirement of the Act if it makes the required "clear and conspicuous" disclosure: (1) on the declarations page of the policy; (2) elsewhere within the policy itself; or (3) in any rider or endorsement that is made a part of the policy, as long as the disclosure is clear and conspicuous and otherwise meets the requirements of the Act.

13. The program covers aggregate insured losses up to an annual limit of $100 billion. Insurers that meet the deductible are not liable for losses in excess of the cap. If the cap is exceeded, Congress must decide who will pay and in what amounts. Primary and excess insurers can only exclude or sub-limit the coverage at the pleasure of the Insured, as they are required to offer the protection at full policy limits. In practice, many carriers plan to continue exclusions, sub-limits and special deductibles for "non-certified" events, and offer full limits for "certified" events at a given premium. The initial Treasury Guidelines (12/3/03) indicate that insureds can request, and insurers can offer, sub-limited terrorism coverage provided that the insurer first makes an offer for full coverage and state regulations allow sub-limiting the coverage.

14. The Treasury Secretary is empowered to assess civil penalties on insurers for submitting false or misleading information. In addition, the Secretary can assess fines against carriers for failure to fulfill their repayment obligations. ■

ATTACHMENT A

Company	Market	Product & Highlights of Coverage	Capacity	Base Premium
Ace USA, Philadelphia	U.S. and Canadian commercial property — may not be available in all U.S. states or Canadian territories	1st party stand-alone coverage, both admitted and non-admitted	$100 million	Varies, depending on exposure
AIG, New York	Airline industry	1st party stand-alone coverage, aviation war risk, hijacking liability coverage	$150 million in excess of $50 million in aggregate, up to $850 million in excess of $150 million; total $1 billion per airline	NA
	Property	American International Companies Property Terrorism Facility — worldwide, domestic & foreign property cover; Property damage & BI cover; locations must be specifically named, policy period not to exceed one year	$150 million per event and in aggregate (maximum any one insured)	$50,000 minimum
Allianz AG, Frankfort Germany	Airline industry	3rd party liability for airlines	Up to $1 billion per aircraft and up to $2 billion per airline per year	Calculated per passenger carrier and applies to all airlines insured

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Arch Capital, Bermuda	Multiple Markets	Coverage on a selected basis — 1st party property damage, excluding nuclear biochemical. Availability varies by territory.	Varies by zone	Varies depending customer/ exposure
AXIS Specialty, Bermuda	Multiple Markets	Terrorism as a 1st party stand-alone; property, aviation, marine	$100 million	Between 1 to 2 percent online
Berkshire Hathaway	Multiple Markets	1st party property coverage; 3rd party coverage available	$500 million	Varies depending on customer/ exposure
Oil Insurance Ltd., Bermuda	Energy company cover (Oil Insurance, Ltd.)	All Risks Physical Damage, Control of Well & 3rd party Pollution Liability — open to all eligible energy companies	$250 million per occurrence — no sublimit	$250,000 per Oil rules with a $5 million deductible
	Energy company cover (Oil Casualty Insurance Ltd.)	3rd party liability and D&O for members	$150 million	$25,000 per OIL rules with a $50 million deductible
	Energy company cover (Senergy Insurance Ltd.)	All risks excess physical damage and well control (on Oil form). BI cover to OIL or OCIL members	$200 million	$375,000 for excess PD and $1.5 million for BI
Lloyd's of London	Multiple markets	1st party physical damage or BI caused by terrorist acts	$200 million	1 to 5 percent of insured limits

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Special Risk Insurance and Reinsurance Luxembourg (Zurich Financial Services, XL Capital Ltk., Swiss Re, SCOR, Hannover Re, Allianz	Property coverage	Physical loss or damage to insured properties — directly resulting from an act of terrorism. European risks only.	EUR 500 million	NA

Source: Betterley Report & Risk & Insurance

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