Terrorism Insurance Update: Congress Acts

By Nelson R. Block

The insurance industry recently responded to a new risk - attacks by foreign terrorists against targets on U.S. soil - by limiting their exposure. Insurers excluded coverage from property and casualty policies, then offered to include it by endorsement priced to cover the additional risks.

Some owners of large projects found it economically infeasible to obtain terrorism insurance, as required by their lenders. *USA Today* reported that only $100 million of terrorism coverage was available for the Golden Gate Bridge, which has a replacement cost of $2.1 billion, and that was at a cost of $1.7 million. The proposed coverage was rejected. Simon Property Group Inc., owner of the Mall of America in Bloomington, Minn., ended a dispute with its lender by purchasing $100 million of terrorism insurance.

Congress's answer to these issues was the Terrorism Risk Insurance Act of 2002, signed into law on November 26, 2002. The Act is a short term solution intended to allow insurance markets to learn how to deal with the risks to commercial properties posed by acts of foreign terrorism. The program created by the Act ends December 31, 2005.

The Act provides $100 billion of federal funds to cover losses from terrorist attacks with a minimum threshold damage of $5 million. These funds will cover 90 percent of losses above deductibles for "certified losses" in excess of the minimum. Deductibles for policies will be set at 7 percent of premiums in the first year of the federal program, 10 percent of premiums in the second year, and 15 percent in the third year.

"Certified losses" are determined by the Secretary of the Treasury, in concurrence with the Secretary of State and the Attorney General. To fit this definition, damaged property must be within the United States, or to a U.S. registered airplane or maritime vessel, or on the premises a U.S. mission. The U.S. includes America's "territorial sea and continental shelf." Offshore oil rigs can probably be covered, as they are often documented as vessels or located on the continental shelf. The definition of "certified losses" excludes events arising from a war declared by Congress, and requires that the terrorist act must be by a foreign person; the Oklahoma City federal building bombing would not qualify.

The Act requires that all carriers described in the Act which write property and casualty insurance - approximately 2,000 insurance companies - must make terrorism coverage available. The Act invalidates terrorism exclusions imposed by private contract, and preempts state laws approving such exclusions. Terrorism coverage can only be excluded if a policyholder refuses to take it or fails to pay the increased premium for it. Many businesses have already received notices advising them that coverage is available.

If there is a certified loss, then a newly created federal cause of action for any injury arising out of any property damage, personal injury or death preempts similar state laws; punitive damages are not covered by insurance. The restrictions do not apply to suits against terrorist organizations.

While the Act worked its way through Congress, the insurance industry itself began analyzing the risks from possible terrorist attacks. This new area posed a challenge in creating risk models. In October 2002, *The New York Times* reported on two groups which had created models based upon different methodologies. These groups used experts in terrorism from the CIA and FBI, engineers, mathematicians and statisticians. One group looked at potential high impact targets - landmark properties, historical buildings, government centers, shopping malls, sports venues, transportation centers, bridges and tunnels - as well as the kinds of weapons which can be used against such targets. It identified 330,000 potential targets and attempted to determine a risk factor for various kinds of projects.

The Insurance Services Office, Inc. ("ISO") is a national insurance advisory group that collects actuarial data and prepares insurance policy forms for approval by state regulatory authorities. Though insurance carriers are free to use their own analysis, many companies use the ISO models.

ISO ranks U.S. cities into three tiers: Tier 1 includes those cities for which the risk of a terrorist attack is 100 times greater than other cities. These cities are New York, Washington, D.C., Chicago and San Francisco. Tier 2 cities have a 5 times greater risk of attack than other cities, and include Los Angeles, Philadelphia, Boston, Seattle and Houston. Tier 3 includes all other U.S. cities.

Now that the back-up coverage provided by the Act is in place and insurers have models for terrorism risks, coverage is available, but the premiums vary, according to Fritz Koehler, vice president of Wisenberg Risk Management + Insurance. He finds that coverage costs more for projects in high-risk cities, or which may be likely targets. The tallest building in Chicago will be expensive to insure for terrorist risks. A strip center in The Woodlands should have affordable premiums. Koehler says that terrorism coverage premiums may be as low as $1,000 to $5,000 for Houston-area apartments, manufacturing plants, low rise office buildings, retail buildings and strip centers.

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