Structuring global insurance programmes for terrorism and political violence

Piers Gregory and Clive Hassett

October 2012

Focus on terrorism and political violence

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Introduction

After more than a decade of highly visible international incidents, it is unsurprising that obtaining insurance for terrorism and political violence has become a key imperative for risk managers of large multinational companies. In fact, recent research by ACE reveals that terrorism and political violence is the top emerging risk concern among businesses across Western Europe.

What may come as a surprise, however, is that losses from terrorism are still excluded from most standard commercial insurance policies and that fewer than 10 percent of those surveyed have dedicated insurance to specifically cover these risks. Indeed, ACE's research suggests that 15 percent of European companies are aware of the potential gaps and a further eight percent are aware but unsure how to obtain cover. In addition, around one in five believes terrorism and political violence risks are covered under one or more policies in their insurance programme, although this may often not be the case in practice.

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A primary reason for this coverage gap therefore appears to be a lack of clarity as to how appropriate coverage can and should be arranged. This is particularly evident in the international arena, where multinational companies may encounter difficulties as they seek to put terrorism insurance in place across their international operations.

Because there is also no universal approach towards insuring terrorism risks, a single global policy issued in London (for example) and intended to provide terrorism cover in multiple countries in Asia, North America and Latin America, is unlikely to be either compliant or work as effectively as intended.

Furthermore, the recent wave of social and political unrest in certain countries has triggered a move to extend policy coverage beyond the traditional "terrorism only form", to cover damage resulting from politically-related violence and even conventional war perils. Such coverage provides clients with greater protection and more responsive policies. But, at the same time, poorly constructed policy wordings have given rise to inconsistencies and gaps in coverage.

This paper reviews some of the arrangements that exist for insuring these risks and reviews the approaches that should be considered when constructing a global programme. In particular, these include the issuance of local policies under a home country 'master policy' as a prudent approach for managing the insurance requirements of multinational companies.

Overview of terrorism insurance

1. Pooling arrangements

Many countries operate pools or loss sharing arrangements to provide cover for terrorism risks, with several having been established after the New York World Trade Center attacks in 2001.

Following this and similar incidents, a number of governments took the view that the commercial insurance market might not be able or willing to continue to provide adequate cover for terrorism losses, and that they needed to step in and promote solutions (or even act as a reinsurer of last resort).

Insurance pooling solutions now exist in a diverse range of territories including Australia, Austria, Belgium, Denmark, Finland, France, India, Namibia, the Netherlands, Russia, South Africa, Sri Lanka, the UK and the US.

These pools generally provide reinsurance rather than direct insurance and, in most cases, the government provides backstop cover which can be capped, as in the US, or unlimited, as in the UK. However some schemes, including those operating in Austria and Finland, do not have government financial support and provide cover only up to the limit of the particular arrangement.

The pools often operate as mutual organisations in which the members are the insurers writing business in a particular country. The pools normally set rates for coverage and, depending on the rules, market practices and competitive conditions, insurers are generally required to use these rates, unless there are specific rules allowing freedom to adjust the rates.

These arrangements operate in a number of different ways, and have their own unique blends of coverage specifications and prescribed rules. For example, terrorism cover must be provided within property policies in some countries, such as France and Spain – with the latter also requiring cover to be provided within life and accident policies. Cover is voluntary in others, including Russia, Austria, the US and the UK. Sometimes, as in the UK, coverage is only provided for commercial risks, whereas in the Netherlands, Belgium and Austria, for example, it is provided for personal risks, including domestic dwellings.

Many of the pools and other arrangements restrict insurance coverage to property damage and do not provide compensation for personal injury. That is because some countries have social welfare schemes or criminal injury compensation bodies that provide payments to people injured in an attack. Indeed, in 1983 the Council of Europe issued a convention on the compensation of victims of violent crimes (ETS 116) which calls on EU member states to introduce national legislation to provide victim compensation arrangements. The convention has been ratified by the majority of EU countries.

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In many countries, pools are not compulsory and, if an insurer chooses not to join a pool, it can make its own reinsurance arrangements when providing terrorism coverage. However, if an insurer joins a pool, in most circumstances it will not be permitted to buy non-pool cover and will also be required to retain a certain proportion of all relevant losses. In line with the principles of mutuality, the pools may make payments of any surpluses to the participating members.

Where governments act as reinsurers of last resort to the pool they will normally receive a share of the pool's income, although this is notably not the case in the US, where the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) does not currently provide for any share of premium to be passed to the federal government.

Over time and with a better understanding of the risks, pools and risk sharing arrangements have provided much-needed certainty for insurance carriers and commercial buyers alike and, in conjunction with traditional insurance markets, now provide substantial global capacity for terrorism risks.

2. Direct compensation

In some countries – including Spain, Israel, Switzerland and Germany – the state, with cooperation from the private local and international insurance sector, provides direct compensation for the damage and injuries resulting from terrorism.

Spain established the Concorcio (CCS) scheme in 1954, whereby the government directly provides compensation for terrorism as well as natural catastrophe losses. This is funded by a percentage charge applied to policy premiums.

Israel has a scheme where compensation is paid directly by the government.

In Switzerland, the members of the local insurance industry association (SIA) came together to deliver a market solution for commercial and industrial risks that developed consistent wordings and arranged reinsurance.

In Germany, terrorism cover is available from the private company Extremus which was set up by 16 insurers in 2002. The company buys external reinsurance and also benefits from limited support provided by the federal government. This state commitment is capped at €8bn and sits above the €2bn annual aggregate provided by Extremus and its reinsurer partners. The state involvement renewed in 2011 and runs to the end of 2013.

Coverage and programme structure

1. Diversity of legislation demand customised solutions

The landscape of terrorism insurance arrangements is both diverse and complicated, with terms and conditions mandated on a country-by-country basis. Any global insurance programme covering terrorism risks must take account of these local terrorism insurance regulations. Once these have been identified, the next considerations are how the programme should be structured and what coverages should be provided. It follows that global terrorism programmes will be bespoke and individual to the specific insured.

In the US, prior to the 9/11 attacks, most property policies did not address terrorism; damage from terror attacks was covered through standard policy wordings. However, within a few months of the attacks, insurers excluded terrorism in most of the 50 states. The Terrorism Risk Insurance Act (TRIA), signed into law in November 2002, provides a level of federal reinsurance to insurers offering the coverage. The underlying principle of TRIA (and its successor TRIPRA), is that terrorism cover must be offered to commercial insurance buyers. However, with the exception of workers' compensation cover in most states, it is not compulsory for the buyer.

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The rules governing the operation of many of the pools and other arrangements are often very detailed and demanding. They address not only technical issues, such as rating, deductibles and coverages, but extend to operational and administrative matters as well.

For example, Pool Re in the UK requires formal client acceptance of a quote within 30 days or cover will not take effect. The Concorcio in Spain demands payment of its levy within 30 days of policy inception to ensure coverage. Other countries are similarly precise, with their own unique terrorism insurance requirements.

In addition to terrorism, policies can be broadened to provide cover against strikes, riots and civil commotion, commonly termed "political violence" (PV), as well as war and civil war. It is important to understand that not all of these risks will necessarily be covered by the various pools and buyers must be extremely attentive to the precise definition of words, expressions, exclusions and endorsements, particularly within the context of a global programme, as countries apply different interpretations to these terms. In its recent report published in association with the UK risk manager association AIRMIC, 'Property insurance: terrorism and political violence', ACE highlights the importance of companies being aware of the nuances of cover and sets out a glossary of terms for the UK market in particular.

A feature of most pools and other national arrangements is that while they generally provide broader coverage than what is available in the standard market, they are dependent on a government or another party's "certification" that the occurrence will be declared as an "act of terrorism" in order to trigger the coverage. Political and economic factors could potentially influence this decision and therefore, to reduce uncertainty, consideration should be given to purchasing coverage for broader political violence related perils that typically are outside of the remit of a standard property policy.

2. Factors to consider when structuring a global programme

When designing a worldwide terrorism insurance programme, there are a number of factors that must be addressed in addition to the typical complexities that arise around more standard global coverages, such as taxes, local and master policy wordings and claims handling protocols.

In some countries, the terrorism insurance structure will be mandated by specific rules, while in others it may be possible to adopt an independent approach. In many cases, there will be no specific rules at all, although in others a combination of a pool and open market solution may be an option.

As a result, the choice of appropriate insurance partners is critical, and a risk manager or insurance buyer should challenge both their broker and potential insurer to clearly demonstrate their understanding and ability to manage the specific characteristics of terrorism cover wherever it is required.

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A number of issues must be clarified as they are approached differently in all existing terrorism schemes. Insurers and brokers operating internationally are familiar with these issues and will be able to assist companies and their risk managers in addressing them for each country in the programme. The development of a matrix around a series of core questions will enable an effective programme to be designed and implemented and ensure there are no gaps in cover, provided that all local rules are correctly followed.

3. A global, integrated approach to terrorism insurance

Almost certainly, the ideal solution for covering terrorism would be for the peril to be included as standard within a regular global property programme, both at the master and local policy level. However this is not generally a realistic option, due to the variety of approaches taken by regulators and indeed insurers, who have different risk appetites and global capabilities.

Checklist of questions to ask when considering terrorism insurance

- ✓ Is terrorism cover included with standard policies?
- ✓ Is terrorism coverage compulsory within property or other classes of business?
- ✓ Is the insurer a member of the national scheme?
- ✓ Is there a finite scheme limit or is the government support open-ended?
- ✓ How broad is the cover offered by the local scheme?
- ✓ Does the cover include political violence, war and civil unrest?
- ✓ Is the cover tariff-rated?
- ✓ What arrangements are in place for compensation in the event of death or personal injury from a terrorist incident?
- ✓ Does the scheme cover NBCR (Nuclear, Biological, Chemical, Radiation) risks?
- ✓ Are stand-alone policies available or is cover provided as an extension to a property policy?
- ✓ How does the scheme operate in the case of layered and co insurance placements?
- ✓ Do the arrangements cover overseas assets of the insured?

As terrorism is such a complex and critical area of insurance, risk managers should strongly consider implementing a global insurance programme so that their company can have a centralised view, control and understanding of the global arrangements across their organisation, which will enable them to clearly explain to their stakeholders the financial protections that are in place.

There are two potential approaches that may achieve this, each with its own specific features and challenges.

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One approach is to put in place a master property policy that includes terrorism and associated coverages, such as political violence, and then to support it with local policies that have extensions to cover these perils and take account of the variety of terrorism insurance regulations in these countries.

The benefit of this integrated approach is that the insurance is underwritten by the same insurer or group of insurers. There should therefore be a clear consensus as to how the policy works, and less uncertainty about how other policies might operate and interact in the event of a terrorism or political violence claim. For example, the anti-government riots in Bangkok in May 2010 gave rise to a number of coverage disputes centred on the definition of the peril that triggered the loss. If the disturbances were classed as civil commotion, then most property policies would respond, but if the damage resulted from acts of terrorism, it would be likely that the local policy would provide no cover. There have also been several other similar coverage disputes arising from the events in the Middle East and North Africa in 2011 that have highlighted the potential difficulties in these situations of civil unrest.

The integrated approach is also likely to be more efficient and cost effective in terms of underwriting, servicing and claims handling as documentation will be reduced and common procedures can be established across all territories.

Another approach is to implement a fully stand-alone terrorism programme with a master policy in the home country, supplemented by local terrorism policies covering overseas subsidiaries.

A stand-alone terrorism programme should be structured with a master policy and local, in-territory policies. The insured will have to consider the extent to which they require full policy limits and conditions locally and the degree to which a master policy Differences in Condition (DIC)/Differences in Limit (DIL) clause may have to respond[1].

Stand-alone programmes can also provide an effective solution and can be considered where an integrated approach is not possible whether because of local regulations, lack of insurer capability to provide such a solution, or other technical reasons such as limit/exposure management. In all policies covering terrorism, it is market practice for sub-limits to be applied in addition to an aggregate limit for the programme.

It is important to note that using stand-alone terrorism policies, written on a “non-admitted” basis,

[1] For a discussion on DIC/DIL clauses in multinational programmes, refer to ACE’s paper, “Stucturing Multinational Insurance Programs: Addressing the Taxation and Transfer Pricing Challenge” at www.acegroup.com/Media-Center/ACE-Perspectives/Multinational.html.

with worldwide coverage being given under a single policy in the home country, exposes the purchasing company (and potentially its broker too), to some very real compliance challenges. These can arise due to the complex rules governing “non-admitted” insurance in general, as well as the terrorism-specific rules themselves. The practical difficulties that arise from the handling of terrorism claims make it highly advisable to have a policy document in place that is in local language and in a form that is capable of relatively straightforward claims adjustment in the affected territory. This would, at a time when rapid business recovery is a priority, help to sure that loss payments were made directly in-country under the local policy rather than to the parent company, which could then encounter delays and tax complications in moving the money to the impacted local subsidiary.

Summary

Terrorism and political violence is an ever-present threat for multinational businesses and will continue to be so in the foreseeable future. However, ACE's research in Europe suggests that many companies may be both underinsured and underprepared to manage these risks. In particular, there may be considerable confusion about what is covered under various different schemes and policies.

The growing trend among multinational companies towards examining their existing global insurance placements for terrorism cover, as a progression of their efforts in recent years to review their global insurance programmes in general, is therefore a welcome development which should help ensure that solutions are both compliant and meet intended business needs.

In respect of terrorism insurance, a single global policy approach will not, in most cases, provide necessary coverage and compliance certainty. It is therefore likely that a growing number of global terrorism programmes with ancillary covers such as political violence will be implemented over the coming years.

Although the construction and operation of these programmes will present challenges and will require a good deal of expertise and experience from brokers and insurers, a global solution for terrorism and related perils is an achievable goal, provided it is developed and constructed in a considered and well researched manner that respects the many different international approaches to this challenging class of insurance.

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More information

To raise awareness of these issues, ACE has published a number of reports dealing with some of the complex issues that arise and how they can be approached. These papers can be found at www.acegroup.com/Media-Center/ACE-Perspectives/Multinational/html. In addition, the ACE report published in association with AIRMIC, ‘Property insurance: terrorism and political violence’ can be found at www.acegroup.com/uk-en/brokers/terrorism-political-violence.aspx.

About ACE

The ACE Group is one of the world's largest multiline property and casualty insurers. With operations in 53 countries, ACE provides commercial and personal property and casualty insurance, personal accident and supplemental health insurance, reinsurance and life insurance to a diverse group of clients. ACE Limited, the parent company of the ACE Group, is listed on the New York Stock Exchange (NYSE: ACE) and is a component of the S&P 500 index. Additional information can be found at: www.acegroup.com.