

TERRORISM LEGISLATION AND INSURANCE PREMIUMS

A NEW WORLD ORDER

Following the terrorist attacks in the United States on September 11th 2001, and the subsequent increase in terrorist threat throughout the world, changes have been announced to the way insurance cover is provided to private houses and blocks of flats in the UK.

This study summarises the findings of County's recent seminar series on the subject, highlights the basic facts of this complex issue and how individual policyholders may be affected.

TERRORISM AS DEFINED BY THE UK JUDICIAL SYSTEM

In the UK, there are two statutory definitions of terrorism and they both indicate that terrorist acts do not necessarily need to be exclusively against the UK or the general UK public to be valid.

However, a judicial decision is necessary, as it is not clear if the two definitions will define terrorism in a similar way or, if there are differences, which version is giving the wider definition.

The Reinsurance (Acts of Terrorism) Act 1993 defines terrorism as:

"any act of any person acting on behalf of or in connection with any organisation with activities directed towards the overthrowing or influencing of any government de jure or de facto by force or violence."

Reinsurance protection applies solely to first party risks of fire and explosion and the UK government must state that

an act of terrorism has occurred to cause the fire or explosion before any cover becomes activated.

The UK Terrorism Act 2000 allows the police greater powers to combat terrorism and defines terrorism as:

"the use or threat of action where –

- (a) it involves serious violence against a person, or it involves serious damage to property, or it endangers a person's life, other than that of the person committing the action, or it creates a serious risk to the health or safety of the public or a section of the public, or it is designed seriously to interfere with or seriously to disrupt an electronic system and*
- (b) the use or threat is designed to influence (any) government or to intimidate the public or a section of the public and*
- (c) the use or threat is made for the purpose of advancing a political, religious or ideological cause."*

Within this definition the terrorist must be associated with a proscribed organisation, the list of which is regularly updated by Statutory Instrument.

Further mismatches may arise due to differences in the way policies are worded by individual insurers. Therefore, it is necessary to cover some ground on how terrorism is perceived by insurance organisations.

TERRORISM AS DEFINED BY THE UK INSURANCE INDUSTRY

The way insurers define terrorism can vary but will usually be based on the *Terrorism Exclusion Clause NMA2920* - a Lloyd's of London definition.

Generally, the exclusion will define terrorism along the lines of:

"...an act, including but not limited to the use of force or violence and or the threat thereof,



of any person or group(s) of person, whether acting alone or on behalf of or in connection with any organization(s) or government(s), 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."

Additionally, the exclusion may apply to:

"...loss, damage, cost or expense of whatsoever nature directly or indirectly caused by, resulting from or in connection with any act of terrorism regardless of any other cause or event contributing concurrently or in sequence to the loss."

The phrasing may also exclude:

"...loss, damage, cost or expense of whatsoever nature directly or indirectly caused by, resulting from or in connection with any action taken in controlling, preventing, suppressing or in any way related to any act of terrorism."

Where the insurer decides to dispute that cover applies in the event of a loss, the burden of proving that there is a valid claim under the policy may be on the insured.

This exclusion is being applied not only to first party property damage policies but also to a number of other ranks of insurance including liability and motor policies. Compulsory exclusions using these words can potentially introduce difficulties and confusion. A degree of caution is recommended; where provisions are not fully understood, seek advice.

THE POOL RE REINSURANCE FACILITY

Pool Re came into being following extensive discussions between the government and the insurance industry when attacks by the IRA in the early '90s threatened to make insurance

cover for acts of terrorism unobtainable.

In the past, terrorism cover was provided within normal buildings insurance policies up to a maximum cover of £100,000.00 for a private house and £2,500,000.00 for blocks of flats.

If cover was required over and above these amounts, this was provided to individual policyholders by the government-backed facility, Pool Re. It was set up in 1993 by statute as a mutual reinsurance facility to provide cover above a threshold for property damage and business interruption from fire or explosion resulting from terrorist activity.



Higher threat, higher buildings insurance premiums

Pool Re, therefore, exists to provide reinsurance cover in the face of ongoing terrorist threat and where market failure to do so threatens the ability of British industry to function in its absence. The UK is widely regarded as one of relatively few countries in the world forced to live with a long-term terrorist threat.

September 11th introduced new forms of terrorism previously not covered under normal policies. This has led to the introduction of a revised Pool Re scheme, which came into effect on January 1st 2003. Normal buildings insurance policies now exclude terrorism cover; the latter needs to be



purchased from the buildings insurer separately and marks a major policy shift.

POOL RE AMENDMENTS AND THEIR EFFECTS ON COMMERCIAL PROPERTY INSURANCE PREMIUMS

Prior to 01/01/03, Pool Re used to operate a “retention” arrangement under which insurers would bear the first amount of any claims for any Pool Re covered events, for each “head of cover”, i.e. section of policies issued by them. This would generally amount to £100,000 per head of cover (though different retentions may apply in certain situations). Ultimately, the total cost borne by an individual insurer depends on the number of heads of cover affected.

The objective of stimulating competition within the insurance market was set, given the fact that Pool Re is the dominant provider of terrorism reinsurance in this sector. In the current market, the most practical way of encouraging commercial capacity back into the market was to raise retention levels, opening the possibility for insurers to seek commercial reinsurance to cover these retentions.

It was felt that a big retention increase would be difficult for smaller insurance companies to absorb. This was particularly the case as it was proposed that cover provided should be extended to “all risks”, since the previous basis for the retention could have led to a very high disproportionate overall loss for an individual insurer.

Therefore, the government sought alternative approaches, and it was endorsed that Pool Re should move to

a per event retention, combined with an annual aggregate limit for each insurer, based on the overall terrorism market share of each insurer.

It is projected that retention will be set for each insurer on an annual basis as a proportion of an “industry-wide” figure. This would in turn facilitate easier absorption of a larger retention by insurers, because they will have certainty about their maximum exposure in any given year, leaving Pool Re (and if necessary the UK government) to bear the cost of a major incident or a terrorist campaign involving a series of incidents.

Each insurer will now have losses restricted under the new basis, both per event and per annum as seen. And this means that insurance companies can even forecast the maximum amount they could be required to pay out in any one year.

As of January 1st 2003, the maximum industry retention level has been set at £30 million per event, with individual insurers’ retentions being based on market share. This represents a moderate increase on retentions based under the previous basis (£100,000 per head of cover per policy).

It is intended that over the next four years the retention will increase steadily, bringing commercial reinsurance in to cover insurers’ retentions or permitting them to retain this element of risk themselves. This increase will be phased to allow the market to adjust to new provisions gradually, and to allow ample time for the reinsurance market to re-establish terrorism capacity following the events of September 11th 2001.



Maximum industry retentions set for the next four years will be as shown in Table 1.

Effective from	01/01/03	01/01/04	01/01/05	01/01/06
Per Event	£30m	£50m	£75m	£100m
Per Annum	£60m	£100m	£150m	£200m

Table 1. The changing face of commercial terrorism insurance market

In reality, the actual amount of retention borne by the industry following an event would probably be considerably less than this, depending on the distribution of claims between insurers.

POOL RE AMENDMENTS AND THEIR EFFECTS ON RESIDENTIAL PROPERTY INSURANCE PREMIUMS

The cost of this separate cover is based upon the total value at risk. This in turn is based on the postcode of the property, and will vary from insurer to insurer. Previously, private dwellings and blocks of flats received preferential terrorism rates over commercial premises. There is no longer any distinction made.

Pool Re provisions	Value of property (Millions £)	Insurance premium (£)
Pre 01/01/2003	Up to 2.5	50.00
Post 01/01/2003	Up to 2.5	175.00 – 1,000.00

Table 2. The changing face of residential terrorism insurance market

Whereas last year blocks of flats with a value of £2.5m or less paid a small proportion of the fixed premium of £50.00 charged under the policy, in future they will have to pay a premium based on the total value. Based on postcode, this could now range from

£175.00 to £1000.00 as illustrated in Table 2.

Generally, home insurers do not provide cover for the effects of chemical, biological and nuclear attacks, though individuals would continue to be able to claim for damage from "conventional" - non-chemical, biological or nuclear – bombs.

PROFESSIONAL ADVICE

In an ever-changing world, our panel of experts continue to offer specialist advice on property matters including the recently introduced terrorism insurance provisions. For more information, please email us at marketing@countystate.co.uk.

FURTHER READING AND ONLINE RESOURCES

- Association of British Insurers (ABI) www.abi.org.uk
- Association of Insurance and Risk Managers in Industry and Commerce (AIRMIC) www.airmic.com
- British Insurance Brokers Association (BIBA) www.biba.org.uk
- British Property Federation (BPF) www.bpf.propertymall.com
- Confederation of British Industries (CBI) www.cbi.org.uk
- HM Treasury www.hm-treasury.gov.uk/newsroom_and_speeches/press/2002/press_73_02.cfm
- Institute of Financial Services (IFS) www.ifs.org.uk/supersite/insurance.htm

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