Terrorism Insurance

Port Administration and Legal Issues Seminar

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Agenda

• London Attacks
• TRIA
• Terrorism Market
London Attacks

- Third major attack on public transit system since 9/11.
- These large-scale attacks illustrate the range of potential targets and the desire to cause collateral damage and maximum casualties.
- Again, no warning was issued.
- Attacks underscore that businesses, organisations and their people will continue to be perceived as targets.
- Transport for London, insured within the UK’s Pool Re.
- Estimates indicate the insured loss below £75m threshold of Pool Re.
- Pool Re has surplus of £1.25bn - unlikely to increase tariff rates.
- Standalone markets unlikely to increase rates.
- Attacks will keep the issue of terrorism at the forefront of public awareness;
London Attacks - Increased Hazard

- Terrorism risk has been a key component of risk management planning since 9/11
- London is a reminder of the risk - it heightens concerns regarding an ongoing and potentially escalating risk
- Creates an environment where maximising shareholder returns and protecting customers, employees and assets will be increasingly challenging
- Insurance risk transfer - coupled with terrorism mitigation - will continue to be a lynchpin in minimising the economic impact of these events

- IMPACT: With all the experience of terrorism in London, The City and the Aon office (situated near to the first explosion) was paralysed and subsequently evacuated
TRIA

• TRIA is a temporary, mandatory federal program enacted November 26, 2002, triggered when an event meets the definition of an act of terrorism.
• For losses above a company’s deductible, the Federal government covers 90%, the company, 10%. Annual losses covered by the program are capped at $100 billion.
• The Act expires at the end of 2005.
• Given that there have been no terrorism incidents in the U.S. since September 11, 2001, there is debate about whether extending TRIA is necessary.
• The U.S. Treasury Dept. issued the first federal report evaluating TRIA on June 30th, 2005.
• Report is largely viewed as a “negative” sign re TRIA’s potential reauthorization.
Comment on The Treasury Report

• Treasury’s conclusion is not supported by Aon’s market data or current market behaviour.
• Aon’s believes the market cannot operate without some form of terrorism backstop
• Report is clearly against reauthorizing TRIA in its current form and presents heavily modified guidelines for any potential replacement
• Report glosses over the potential for market disruption, does not acknowledge the clear role TRIA played in terms of increasing capacity/decreasing pricing and is unrealistic in terms of its predictions of private reinsurance replacing TRIA capacity in the near term
• ‘Administration’ requirements for any reauthorization
  – Sizeable increase in the loss threshold from $5 mm to $500 mm
  – Substantial (undefined) increase in the insurance industry’s retention
  – Accelerated government payback that minimises taxpayer exposure
  – Ties reauthorization to tort reform
  – Would limit scope of insurance lines that are reinsured
Comment on The Treasury Report (cont.)

• In TRIA’s absence, insureds will have two options:
  – Terrorism coverage from the limited speciality “standalone” terrorism markets
  – Rely on coverage from the standard commercial insurance market - the very same market that began to exclude coverage after 9/11
• If the industry is required to bear more risk exposure, prices will increase accordingly - potentially at a multiple of current rates
• Companies should prepare for a seller’s market in terms of terrorism capacity
• TRIA has importance to multiple classes of business
• Reinsurance backstop is ultimately an issue of economic security and providing the US with the ability to absorb catastrophic losses
TRIA in the balance

Clients faced with the prospect of a market without TRIA should:

• Negotiate for full-term terrorism coverage from carriers
• Review all language relative to “conditional” terrorism exclusions
• Secure stand-alone terrorism coverage to cover any gaps in programs that may appear if TRIA expires
• If a captive is used to access TRIA, ensure that this coverage can be replaced either at renewal or 1/1/06 with terrorism capacity
• Expect a severe dislocation between supply and demand for terrorism capacity
• Without TRIA, the market will be fundamentally different in terms of both capacity and price
TRIA in the balance - Summary

• Terrorism risk will remain an issue - with or without TRIA
• Aon’s position continues to be that the market cannot operate without some form of terrorism backstop
• The attacks in London are a sad reminder of the threat of terrorism
• TRIA is an opportunity to provide the US economy with catastrophic risk protection - the Treasury Report threatens to end this protection
• The private market cannot operate without some form of terrorism backstop. Without a backstop, the impact on insurance capacity will be equivalent to erasing nearly half of the stock market’s capitalisation.
• Impact being felt **now** - majority of property markets have adopted some form of terrorism exclusion for risks extending beyond 2005.
Standalone Terrorism Market

- Property per risk capacity limited to $1.2bn
- Limited Casualty capacity
- More capacity is expected at 1/1/06, possibly including some new entrants to the market
- A standard market policy form is utilized by all carriers – the T3 form
- T3 is non-cancellable by either party and can protect on a global basis.
- Broad definition of ‘Terrorism’ within T3 policy:
  “An act of terrorism means an act, including the use of force or violence, of any person or group(s) of persons, whether acting alone or on behalf of or in connection with any organization(s), committed for political, religious or ideological purposes including the intention to influence any government and/or to put the public in fear for such purposes”.
Standalone Terrorism Market (cont.)

• Have paid a number of claims over recent years.
• Expect to pay claims following London bombings and will continue to offer terrorism capacity. Market has not indicated desire to increase general terrorism rates
• Likely to see a short-term aversion to public transit risks (as was noted following Madrid Train attack)
• Severe capacity crunch already in certain ‘Tier 1’ city locations, particularly Manhattan
• Non ‘Tier 1’ exposures can be competitively priced as carriers look for risk ‘diversification’
• Pricing at 1/1/06 could spike for certain risks/locations absent TRIA reauthorization