US Terrorism Risk Insurance Act of 2002

Guidance Note

November 2002

Heath Lambert Group

ANY TERRORISM EXCLUSION IN FORCE AT 26 NOVEMBER 2002 IS NOW VOID - INSURERS ARE NOW ON RISK!

The Terrorism Risk Insurance Act of 2002 (TRIA) became law in the US on **26 November 2002**. This compels insurers to start underwriting terrorism risks again.

At present the Act throws up more questions than answers and many grey areas are still to be clarified. Guidance is still required from the US Treasury.

This note serves simply to set out the main points of cover for information purposes.

Mandatory participation

In general the requirements apply to all admitted insurers and surplus lines carriers. All "eligible" insurers must participate and "make available", in respect of all commercial property and casualty policies, cover for insured losses from "Acts of Terrorism" that does not differ materially from terms, amounts and other cover limitations applicable to non-terrorist acts.

It prohibits terrorism exclusions now

The act prohibits terrorism exclusions at both individual insurance company level and state level with effect from 26 November 2002 (the date of enactment). Any terrorism exclusion in force on a policy at 26 November 2002 is declared void – so insurers are on cover for this now.

The clock is ticking

Insurers have 90 days from 26 November 2002 to send a notice to their insureds/customers/policyholders quoting an additional premium to provide "full" terrorism cover. Failure by the insurer to comply may result in certain penalties levied by the US government and loss of reinsurance (see below regarding Federal Backing). The insured then has a 30 day notice period to pay the additional premium or elect (in writing) to reinstate the terrorism exclusion or limitation.

It affects all US exposure

This is an industry issue affecting all insurers and customers with US exposure. The act applies to all US locations **not just US Insureds**.

Federal Backing

Insurers will retain a deductible amount (calculated as a percentage of gross premiums earned for qualifying property and casualty classes). Above the deductible, the Federal Government will reimburse 90% of losses up to a $100 billion annual aggregate liability limit (the "federal backstop").

Consultation

Industry liaison is ongoing between the US Treasury Secretary, US Legal Counsel, Market Associations and London Market Insurance Brokers Committee ("LMBC"). Heath Lambert Group is in consultation with LMBC and any queries regarding the operation of the Act should be directed to LMBC via our Group Compliance Officer, Derek Thornton, Heath Lambert Group, Friary Court, Crutched Friars, London EC3N 2NP.

Your questions answered

1 How is an "Act of Terrorism" defined?

An Act of Terrorism means:

- An act of terrorism as defined by the US government.
- A violent act or act that is dangerous to human life, property or infrastructure

It must result in damage:

- within the US; or
- outside the US in the case of any US flag air carriers or vessels, or vessels based principally in the US on which income tax is paid and which is subject to US regulation; or
- at the premises of a US mission

However it must be committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of an effort to coerce the civilian population of the US or to influence the policy or affect the conduct of the US by coercion.

"Act of Terrorism" under the Act does not include:

- events where property and casualty losses from the event do not exceed $5,000,000 in the aggregate;
- an act committed as part of a war except for workers' compensation

2 Who are "Eligible" Insurers?

- All Insurers licensed in one or more US states
- An eligible surplus lines carrier listed on the quarterly listing of alien insurers of the NAIC
- All Insurers approved by Federal agency for Marine, Aviation or Energy (e.g. Coast Guard, MMS, FAA)
- State Workers Compensation Funds and Residual Market Pools
- "Captive Insurers and other Self Insurance Arrangements" if Treasury Secretary determines to apply TRIA to such entities (must be pre event determination)
- Any entity that receives direct earned premium for any type of property and casualty cover.
- Any other criteria the secretary reasonably prescribes

3 Which Commercial Property and Casualty Lines are affected?

All Except :

- Reinsurance
- Crop
- Medical Malpractice
- Personal Lines
- PMI (Private Mortgage Insurance)
- Mono-line Financial Guarantee
- National Flood Insurance
- Life and Health

4 What is the immediate effect?

Insurers who currently exclude terrorism must either:

(a) Provide a quotation to extend the cover to include terrorism coverage within 90 days of 26 November 2002 stating the additional premium amount and that the exclusion will be reinstated if the Insured fails to pay the additional premium requested by the Insurers within 30 days; or

(b) Receive a written statement from the Insured that they are in agreement to reinstatement of any terrorism exclusion.

If method (a) is utilised then the Insurer is on risk for terrorism cover unless the Insured fails to pay the additional premium requested by the Insurers within 30 days.

For new or renewal business issued after 26 November 2002:

(a) If issued within 90 days of 26 November 2002, must show clear and conspicuous disclosure of the premium charged for terrorism losses and the Federal share of any insured loss.

(b) If issued 90 days after 26 November 2002 show clear and conspicuous disclosure of the premium charged for terrorism losses on a separate line of the policy and the Federal share of any insured loss.

5 How does the Federal "Back Stop" work?

The Insurer must retain a deductible amount before federal assistance kicks in as follows:

Per Insurer (Syndicate) Deductible (Annual Aggregate)
2002 – 1% of Direct (Earned) Premium
2003 – 7% of Direct (Earned) Premium
2004 – 10% of Direct (Earned) Premium
2005 – 15% of Direct (Earned) Premium

Direct earned premium means a direct earned premium for property and casualty issued by an insurer for insurance against losses occurring at the US locations described above.

The Federal Government will bear 90% of losses after exhaustion of the Insurer deductible with the Secretary determining the pro rata share to be paid by each insurer.

A "programme" aggregate liability limit applies of $100 billion per programme year.

The Act does not prevent insurers from obtaining reinsurance for terrorist acts (for their deductible or 10% coinsurance) nor does it extend the cover under any existing reinsurance agreement.

6 What should clients do?

- At this stage, there is very little to do, as discussions are taking place concerning the mechanics of insurers quoting for this extended cover.

- Once this has been resolved and a notice has been sent, clients should liaise with us and confirm whether they accept and wish to proceed with the cover. Clients will have 30 days to pay the additional premium.

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