



Current Articles 2002 – February

Terrorism

Prior to September 11 reinsurers were indicating that reinsurance costs would rise significantly with the renewal of reinsurance treaties which for the most part is January 1. This increase is due to deteriorating results caused by an increase in both frequency and severity of claims, a declining return on equity and lower interest rates giving a lower than normal return on investment.

Reinsurance protects the solvency of insurers for claims which are larger than the primary insurer can financially accept. Apart from arranging for higher limits, insurers also protect themselves by reinsuring catastrophic events. However, shortly after September 11, the reinsurers announced that their renewal treaties would totally exclude terrorism. With regard to catastrophic claims, such as terrorism, a primary insurer has three choices: 1st; to reinsure such claims; 2nd; to hold loss or damage by such a catastrophe "net" in other words, to accept all of the catastrophic loss themselves; 3rd; to exclude coverage for such a catastrophe. Obviously insurers had no choice but to follow the exclusions dictated by the reinsurers and exclude terrorism.

Shortly after the WTC there were concerns as to whether these events would be covered by insurance or whether they would be excluded because of the "war risk" exclusions. The President of the United States had stated that they were a "nation at war". "War" generally requires force, violence etc., between two nations or politically organized governmental bodies. Osama bin Laden and the al-Qaeda are not considered to be a nation, state or even a quasi-government body but are recognized as a network of terrorists. The Taliban is recognized as a government body by only two countries which is far from a majority's recognition that the Taliban is a governmental or quasi governmental body and thus to be a combatant in a war. Therefore it was deemed that the war exclusion does not apply. A Canadian definition of war is " A conflict carried on by force of arms as between nations or between parties within a nation." This definition may have also not permitted the war exclusion to apply, had the loss occurred in Canada.

The industry has introduced or announced terrorist exclusions to be effective January 1, 2002. Some insurers have not finalized their wordings while others are scrambling for reinsurance treaties. It appears that there will be no standard terrorist exclusion, despite the fact that the IBC have introduced specimen wordings. Brokers must use caution in advising clients if there be significant differences in the exclusions. Provincial Insurance Acts will not permit the terrorism exclusion to exclude losses caused by fire or certain explosions. This means that should there be a terrorism claim for loss or damage to property, resultant damage caused by fire or explosion will be covered. All exclusions that I have seen do have a common definition of terrorism - "means an ideologically motivated unlawful act, including but not limited to the use of violence or force or threat of violence or force, committed by or on behalf of any group(s), organization(s) or government(s) for the purpose of influencing any government and/or instilling fear in the public or a section of the public." This is a similar definition being introduced in the U.S. and it has been stated that the trial lawyers will have a "hay-day" pulling it apart.

Another solution is to cap terrorist losses and allow the government to backstop insurers. The proposal to the U.S. Congress is that insurers pay up to \$10 billion in damages and Washington will finance 80% or 90% of losses over \$10 billion. The insurers would be required to repay the government through assessments on all commercial property premiums over an agreed period of time. A similar proposal has been submitted to the government in Canada but at the time of writing has not been endorsed.

Rates were going up before September 11. The WTC added to this increase and has created the terrorist exclusion. We are in a current "hard market" for availability of coverage, premiums and required limits. In my 40 years in the business I have observed several "hard markets" caused by lack of investment income and insurer's "deficit" underwriting techniques, panic events such as the "Brampton Case", etc. I believe that this current market will remain hard and maybe more difficult for a period of time longer than ever experienced in the past!

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