



The U.S. Terrorism Risk Insurance Act

By Katharina K. Brekke

As a result of the tragic events of September 11, 2001, many insurers were reluctant to or would no longer cover terrorism risk under their policies.

The US Congress, in an effort to prevent this widespread dislocation in the insurance market, and to make sure that businesses would have an opportunity to adequately insure their property enacted the Terrorism Risk Insurance Act, PL 107-297 (HR 3210) (hereinafter "Act").

On November 26, 2002, President George W. Bush signed the Act into law. The purpose of the Act is to establish a temporary Federal program (ending 2005) providing for a system of shared public and private compensation for insured losses resulting from an act of terrorism. The Act became effective immediately. Not only did the Act terminate existing terrorism exclusions on current insurance policies, but the Act made it mandatory for com-

mercial property and casualty insurance companies covered by the Act to make terrorism insurance coverage available to their policyholders. However, terrorism insurance coverage already in place was not affected if it complied with the Act.

The purpose of the Act is to establish a program providing for a system of shared public and private compensation.

For business and individuals having property in the United States (and in limited cases outside the United States) the passage of this legislation will have important ramifications and, possibly, a significant fiscal impact.

This article will give a brief overview of some of the key factors dealing with the application of the Act, in particular the scope of the coverage. The article will also give a brief overview of the shared public and private compensation mechanism for insured losses under the Act.

Scope of Coverage

The Act makes the Department of Treasury the authority to administer the implementation of the Act and to issue necessary guidelines and regulations. In an effort to clarify some of the issues arising immediately after the enactment of the Act, the Department of Treasury issued interim guidelines on December 3, 2002, December 18, 2002 and on January 22, 2003.

To determine the coverage of the Act, one must first determine what is an “act of terrorism”, what is the “geographical scope” of the Act, and finally what entities are “Insurers” under the Act.

A) Act of Terrorism

The Act only addresses defined categories of terrorism. In accordance with Section 102(1)(A) the Secretary of the Treasury with the Secretary of State and the Attorney General will certify what acts will be covered by the Act. The Act itself states that the act must be a “violent act” or an act that is “dangerous to human life, property or infrastructure.” However, the Act will not apply if the act is committed as part of the course of war declared by Congress.

B) Geographic Scope

Even though the act is determined to be an act of terrorism, the Act will only cover inci-

dents committed within a defined territory. The Act, in Section 102(1)(A), defines this as any area to be either “within the United States”, or to an “air carrier”, “US flag vessel” or other “vessels based principally within the United States on which United States income tax is paid and whose insurance coverage is subject to regulation in the United States” or, any “premises of any US missions” (any US Embassy abroad or consulates). Thus, certain losses will be covered even if the incident takes place outside the United States, e.g. on board a US vessel. However, the Act may cover non-US entities such as non-US vessels within the territory of the United States (as long as their insurer is one covered by the Act as well.) Furthermore, it also means that an US air carrier will be covered even when outside the United States. The Department of Treasury’s Interim Guidelines dated 01/22/03 determined that “insured loss” under Section 102(5)(b) of the Act, includes losses to a US air carrier and a US flag vessel regardless of where the loss occurs. Furthermore, the Department of Treasury stated in the guidelines that it would not include losses incurred by third parties that are associated with losses incurred by a United States air carrier or a United States flag vessel, unless the cause of the loss originated within the

United States. Thus, cargo onboard US vessels or US air carriers, outside the United States will not be covered by the Act.



C) Participants

The Act requires that each entity that meets the definition of “Insurer” must make terrorist insurance coverage available to its insureds. Section 102(6) of the Act defines who is an “Insurer” under the Act. An entity which is either “Licensed or admitted to engage in the business of providing primary or excess insurance in any State (‘States’ includes the District of

On November 26, 2002, President George W. Bush signed the Act into law, making it effective.



Columbia and territories of the United States”, or “...eligible surplus line carrier listed on the Quarterly Listing of Alien Insurers of the National Association of Insurance Commissioners”, or “Approved for the purpose of offering property and casualty insurance by a Federal agency in connection with maritime, energy or aviation activity” or “A State residual market insurance entity of State workers’ compensation fund” Thus, the definition of an “Insurer” may affect many non-US insurance companies, but only for losses within what is determined the geographical territory of the Act.

The Act requires insurers to disclose to their policyholders details about the Act, including the availability of terrorist risk insurance coverage. For policies issued more than 90 days after November 26, 2002, the Act requires disclosure to be made on a separate line item in the policy at the time of offer, purchase or renewal of the policy. The goal is to make coverage available to policyholders for terrorism risk, which does not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism. The premium information must be made available annually to the Secretary of the Treasury. Thus, the rates are not subject to prior approval, however rates may be subject to subsequent review.

Federal Coat Sharing Program

As mentioned in the introduction, this program is based on a shared coverage between the private and public sector. There will be no coverage by the Federal government unless the loss is for more than \$5million. If the loss is over \$5 million then each insurer will have a deductible equivalent to a certain percentage of each insurer’s earned premiums for the previous year. The first year the program is in place (2003) the deductible will be equivalent to 7% of the earned premi-



KATHARINA K. BREKKE

Katharina K. Brekke is an associate in the Norfolk, Virginia office of the international law firm of Vandeventer Black LLP. Ms. Brekke is a member of the International Business Group. She is admitted to practice in Virginia and is qualified to practice in Norway and Sweden. Ms. Brekke is fluent in German, English, Norwegian, Swedish and Danish.

ums. The second year of the program (2004) the percentage will be 10%. And the final year of the program (2005) the percentage will be 15% of earned premiums. In addition to the percentage of earned premiums the insurer must also cover 10% of the loss. The federal government will cover the remaining 90% of the loss. The insured losses covered by the program are capped at \$100 billion. Under the Act the Federal government may recover a portion of any payments made under the program, referred to as the "insurance marketplace aggregate retention amount." This amount will be the maximum amount all insurers participating in the program will be liable to pay out for certified terrorism losses during a given program year. The Act specifies the insurance marketplace aggregate retentions to be \$10 billion (2003), \$12.5 billion (2004) and \$15 billion (2005). Whether the Federal government may recover will depend on the amount already paid by the insurers as deductible and percentage participation. If these amounts exceed the specified aggregate retention, then there will be no mandatory recoupment. However, the Act gives the Secretary of the Treasury the discretion to require additional recoupment beyond the insurance marketplace aggregated retention amount.

Conclusion

The program is meant to be a temporary program and is supposed to terminate in 2005. Hopefully, by then there will be commercial terrorist insurance coverage available with coverage for insured losses similar to terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism. Then the system will no longer require the Federal government to be a part of the program, to overview the process and make

Additional guidelines and regulations are needed to make this program work properly and as intended.

sure that proper coverage is in place. However, additional guidelines and regulations are needed to make this program work properly and as intended. When the Act was passed it raised various issues with regard to its application and implementation. It will be up to the Department of Treasury to make sure that the goal is met in giving businesses reasonable and predictable insurance premiums with regard to terrorism risk coverage, by implementing, in addition to the interim guidance already in place, rules and regulations to administer and implement certain elements of the Act.

ADVERTISEMENT

1/3 PAGE AD
EMPIRE