

# TERRORISM COVERAGE AND THE UNITED STATES INSURANCE INDUSTRY: AN INTERNATIONAL INQUIRY IN SEARCH OF A LONG-TERM SOLUTION

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## I. INTRODUCTION

Despite the view of many Americans prior to the shocking terrorist attacks on the United States on September 11, 2001,<sup>1</sup> terrorist attacks are not rare occurrences worldwide.<sup>2</sup> “Over 14,000 *international* terrorist attacks have taken place worldwide since 1968,” resulting in over 10,000 deaths.<sup>3</sup> In the past 20 years the United States has seen a rise in domestic terrorism, illustrated by the Oklahoma City Federal Building bombing in April 1995, which resulted in 168 deaths and 642 injuries, and the bombing at the 1996 Summer Olympics at Centennial Park in Atlanta resulting in 2 deaths and 112 injuries.<sup>4</sup>

The World Trade Center bombing in 1993, however, was America’s first exposure to a serious international terrorist attack on United States soil.<sup>5</sup> The 1993 World Trade Center bombing, perpetrated by a “loosely

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1. See generally *September 11: Chronology of Terror* (chronicling the events of September 11, 2001, including the use of hijacked airliners to attack the World Trade Center in New York City and the Pentagon in Washington D.C. and an aborted attack resulting in a jetliner crash in Somerset County, Pennsylvania), *at* <http://archives.cnn.com/2001/US/09/11/chronology.attack/> (Sept. 12, 2001).

2. See U.S. DEP’T OF JUSTICE, FED. BUREAU OF INVESTIGATION, TERRORISM IN THE UNITED STATES 15 (1999) (calling “terrorism one of the oldest forms of human conflict”), *available at* [www.fbi.gov/publications/terror/terror99.pdf](http://www.fbi.gov/publications/terror/terror99.pdf) (last visited Feb. 24, 2005); *see also id.* at 37 (stating that “there were 392 international terrorist attacks worldwide in 1999”).

3. *Id.* at 15; *see also id.* at 21-25 (discussing trends in international terrorist groups); *id.* at 52 (listing recent terrorist attacks in other countries) (citing U.S. DEP’T OF STATE, OFFICE OF THE COORDINATOR FOR COUNTERTERRORISM, PATTERNS OF GLOBAL TERRORISM 1999).

4. *Id.* at 21, 22. “327 incidents of terrorism or suspected incidents of terrorism in the United States” were recorded by the FBI between 1980 and 1999. *Id.* at 16. The FBI attributed 239 of these incidents to domestic terrorists and 88 incidents to international terrorists, which when combined, resulted in 205 deaths and more than 2,037 injuries. *Id.*

5. *Id.*

affiliated group of international extremists,”<sup>6</sup> resulted in 6 deaths, over 1000 injuries, and over \$500 million in damages.<sup>7</sup> Despite both the rise of domestic terrorism in the United States and the previous international terrorist attack on the World Trade Center, neither prepared America for the devastating events of September 11, 2001.

This Note will provide a survey of terrorism’s effects on numerous countries’ economies and insurance industries, and national governments’ resulting responses. Part II examines the devastating damage international terrorism inflicted on the United States insurance industry following the events of September 11 and the industry’s subsequent response. A need for government intervention in the United States to make terrorism insurance available will be examined in Part III. Part IV outlines the technical elements of the Terrorism Risk Insurance Act that was enacted following the events of September 11. Part V addresses views of proponents and opponents in response to passage of the Terrorism Risk Insurance Act of 2002. Terrorism insurance coverage in Europe prior to September 11 and coverage solutions resulting from September 11 are addressed in Part VI. Parts VII, VIII, and IX outline terrorism pools in existence prior to September 11 in Spain, the United Kingdom and France, each of which has been amended following the events of September 11. In conclusion, Part X stresses the need for a long-term solution that may only be possible through a government-backed program.

## II. TERRORISM STRIKES THE UNITED STATES

### A. *Terrorism’s Effect on the United States Insurance Industry*

The terrorist attacks on September 11, 2001 inflicted devastating damage resulting in death, injury, business interruption losses, and property damage.<sup>8</sup> Estimates total the loss of life at 3,000 people, and monetary losses between \$35 billion and \$75 billion.<sup>9</sup> This extraordinary loss was distributed widely throughout the insurance industry,<sup>10</sup> and

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6. *Id.* at 17.

7. *Id.* at 21, 22.

8. H.R. REP. NO. 107-300, pt. 2, at 2 (2001).

9. Richard Allyn & Heather McNeill, *The Fall and Rise of Terrorism Insurance Coverage Since September 11, 2001*, 29 WM. MITCHELL L. REV. 821, 826 (2003) (citing Mark A. Hofmann & Meg Fletcher, *Loss Picture Still Unclear*, BUS. INS., Sept. 9, 2002, at 10).

10. Jeffrey E. Thomas, *Exclusion of Terrorist-Related Harms From Insurance Coverage: Do the Costs Justify the Benefits?*, 36 IND. L. REV. 397, 400 (2003); see also

“inflicted possibly the largest losses ever incurred by insurers and reinsurers from a single set of events.”<sup>11</sup> The majority of the financial loss was borne by the insurance industry’s commercial property and casualty insurance sectors.<sup>12</sup>

The events of September 11 left many wondering if the United States insurance industry and economy could withstand the substantial losses.<sup>13</sup> “Depending on which estimate is used, the insured losses from the September 11 attack were at least *double* the next largest loss in history, and could be as much as *five times greater*.”<sup>14</sup> As a result of the extraordinary losses incurred because of the terrorist attacks on September 11, the loss to the casualty insurance industry “exceeded the profits of the insurance industry for five years,”<sup>15</sup> and severely disrupted the market for terrorism coverage.<sup>16</sup> The United States economy also suffered as a result of international terrorism striking American soil.<sup>17</sup> In April of 2002 alone, 79,000 construction and real estate jobs were lost according to the White House, and commercial real estate construction plunged 20% during the first quarter of 2002, according to the United States Department of

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*id.* (“The Insurance Information Institute estimates the following distribution of losses: property insurance, 22%; aviation hull, 1%; business interruption, 26%; event cancellation, 3%; worker’s compensation, 10%; life insurance, 16%; aviation liability, 9%; other liability, 13%.”) (citing Robert P. Hartwig, *The Long Shadow of September 11: Terrorism & Its Impacts on Insurance and Reinsurance Markets*, at <http://www.iii.org/media/hottopics/insurance/sept11/content.print> (July 25, 2002)).

11. H.R. REP. NO. 107-300, pt. 1, at 12 (2001).

12. *Id.* at 13.

13. See Allyn & McNeff, *supra* note 9, at 831 (stating that “members of the insurance industry posited that the losses generated by the September 11 attack threatened the survival of the insurance industry”) (citation omitted).

14. Thomas, *supra* note 10, at 399 (citing Hartwig, *supra* note 10). Hurricane Andrew, in 1992, was the next largest single-event loss causing \$15.5 billion in insured losses to be borne by the insurance industry. *Id.*

15. Terrence Chorvat & Elizabeth Chorvat, *Income Tax as Implicit Insurance Against Losses from Terrorism*, 36 IND. L. REV. 425, 438 (2003).

16. Dep’t of the Treasury, *Presentation of the Terrorism Risk Insurance Program Executive Director Jeffrey Bragg to the Vermont Captive Insurance Association* (Aug. 11, 2003) [hereinafter *Presentation*], available at 2003 WL 21910591, at \*1.

17. President George W. Bush, Statement Upon Signing H.R. 3210, in 2002 U.S.C.C.A.N. 1436, 1437. “More than \$15 billion in real estate transactions have been canceled or put on hold because owners and investors could not obtain the insurance protection they need. Commercial construction is at a 6-year low, and thousands of hardhat workers have been kept off the job.” *See id.* (discussing the need for the Terrorism Risk Insurance Act to revitalize the United States economy).

Commerce.<sup>18</sup>

### B. Insurance Industry Response to the Events of September 11

Initially, after the events of September 11, concerns were raised regarding attempts by insurance companies to invoke war risk exclusions<sup>19</sup> existing in most standard insurance policies.<sup>20</sup> However, insurance carriers assured policyholders that war exclusions would not be invoked to deny coverage.<sup>21</sup> This was likely a well-informed decision, because prior to September 11, the Second Circuit determined in *Pan American World Airways, Inc. v. Aetna Casualty & Surety Co.*<sup>22</sup> that the hijacking and subsequent destruction of a plane by terrorists was not an act of war constituting coverage exclusion under the standard insurance policy's war risk exclusion.<sup>23</sup> Congress was also clear in its position: “Any attempt to evade coverage obligations by either primary insurers or reinsurers based on such legal maneuvering would not only be unsupportable and unpatriotic—it would tear at the faith of the American people in the

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18. Albert Warson, *Rebooting Terrorism Insurance*, MORTGAGE BANKING, Sept. 2002, at 56, 57.

19. See Jeffrey W. Stempel, *The Insurance Aftermath of September 11: Myriad Claims, Multiple Lines, Arguments over Occurrence Counting, War Risk Exclusions, the Future of Terrorism Coverage, and New Issues of Government Role*, 37 TORT & INS. L.J. 817, 818 (2002) (noting that war risk exclusions are found in nearly all insurance policies which exclude insurance coverage for losses resulting from acts of war).

20. Though few insurance policies prior to September 11 contained terrorism exclusions, all policies excluded coverage for damages that were caused by war. James G. Rizzo, *Tragedy's Aftermath: The Impact of 9/11 on the Insurance Industry*, BOSTON B.J., Jan./Feb. 2002, at 10, 12.

Traditionally, war takes place between two or more sovereign powers for purposes of amassing empires, acquiring territory, or otherwise protecting national interests. Terrorism on the other hand, is defined as “the unlawful use of force and violence against persons or property to intimidate or coerce a government, the civilian population, or any segment thereof, in furtherance of political or social objectives.”

*Id.* (quoting 28 C.F.R. § 0.85 (2001)).

21. *Id.* at 10 (citing “*Act of War*” Exclusion Doesn’t Apply to Attacks, *Insurers Say*, L.A. TIMES, Sept. 17, 2001, at Bus. 3).

22. *Pan Am. World Airways, Inc. v. Aetna Cas. & Sur. Co.*, 505 F.2d 989 (2d Cir. 1974).

23. *See id.* at 1015 (There, the hijacking was not an act of war because “[t]he hijackers did not wear insignia. They did not openly carry arms. Their acts had criminal rather than military overtones. They were the agents of a radical political group, rather than a sovereign government.”).

insurance industry.”<sup>24</sup>

Though insurance companies did not invoke war risk exclusions, insurers indicated that terrorism exclusions would be introduced to new policies and existing policies due to be renewed.<sup>25</sup> After September 11, reinsurers<sup>26</sup> were unwilling to reinsurance terrorism coverage because of the difficulty in pricing terrorism insurance.<sup>27</sup> Citing uncertainty regarding the frequency or magnitude of future attacks, insurers determined that terrorism was an uninsurable risk due to the extraordinary potential exposure.<sup>28</sup>

### III. TERRORISM: A THREAT TO THE NATION’S ECONOMY

#### A. *Terrorism Insurance as a Viable Option?*

Post-September 11 insurance premiums increased dramatically, to the extent that terrorism insurance was available at all,<sup>29</sup> with premiums

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24. Rizzo, *supra* note 20, at 12 (quoting Letter from the House Committee on Financial Services, to the National Association of Insurance Commissioners 1 (Sept. 17, 2001)).

25. See H.R. REP. NO. 107-300, pt. 1, at 13 (2001) (noting that because predictions and loss accounts due to terrorists attacks could not be measured, insurers and reinsurers planned to implement terrorism exclusions or offer limited coverage at a very high cost).

26. To spread risk and meet regulatory capital requirements, primary insurance companies purchase reinsurance, which provides insurance for insurance companies. *Id.*

27. *How Much Are Americans at Risk Until Congress Passes Terrorism Insurance Protection?: Hearing Before the Subcomm. on Oversight and Investigations of the House Comm. on Fin. Servs.*, 107th Cong. 3 (2002) [hereinafter *Hearings*] (statement of Richard J. Hillman, Director, Financial Markets and Community Investments).

28. *Id.*

29. *Id.* at 6; see *Economic Impact of the Lack of Terrorism Risk Insurance: Hearing Before the House Subcomm. on Oversight and Investigation Comm. on Fin. Servs.*, 107th Cong. 53 (2002) [hereinafter *Lack of Terrorism Risk Insurance Hearings*] (statement of Mark J. Warshawsky, Deputy Assistant Secretary for Economic Policy, U.S. Department of the Treasury). Testimony before Congress confirmed that:

In some instances the total policy cost with limited terrorism coverage is reported to be roughly double the cost of the P/C policy without the terrorism coverage. Stand alone coverage for terrorism risk is very limited and quite expensive where it is available. In fact, separate terrorism risk coverage costs more than the insurance covering all other risks while it provides a lower limit and responds to only one event.

doubling or even quadrupling, making terrorism insurance unaffordable for most businesses.<sup>30</sup> In the event that terrorism coverage was available at all, premiums were set high by insurers because of uncertainty regarding attack frequency and costs.<sup>31</sup> Insurance premiums unrelated to terrorism also increased dramatically, threatening harm to the nation's economic recovery with median rate increases reported at 30-50% and mean rate increases reported at 40-70%.<sup>32</sup> Because lenders refused to lend capital to properties that were not fully insured against all types of risk, the nation's economic future was uncertain.<sup>33</sup> Without terrorism insurance sufficient to secure lenders, large construction projects were abandoned, causing the loss of many jobs and postponement of investment opportunities, threatening future economic growth.<sup>34</sup>

#### B. A Need for Government Intervention

In an unprecedented, unified move, the historically state-regulated insurance industry requested federal assistance following the events of September 11.<sup>35</sup> Government-backed terrorism insurance, however, is not a radical concept in countries beyond the borders of the United States.<sup>36</sup> Furthermore, the request for the federal government to act as a reinsurer of last resort was not an extreme proposal because the federal government has acted as a reinsurer of last resort in reinsurance programs for flood

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*Id.*

30. Jeffrey Manns, Note, *Insuring Against Terror?*, 112 YALE L.J. 2509, 2523 (2003) (citing Daniel B. Rubock & Tad Philipp, *CMBS: Moody's Approach to Terrorism Insurance for U.S. Commercial Real Estate*, CMBS WORLD (Commercial Mortgage Sec. Ass'n, New York, N.Y.), Spring 2002, at 48, 50, available at [http://www.CMBS.org/cmbs\\_world/data/articles/SP02\\_CMBS\\_Moodys\\_App.pdf](http://www.CMBS.org/cmbs_world/data/articles/SP02_CMBS_Moodys_App.pdf) (last visited Feb. 25, 2005)).

31. Allyn & McNeff, *supra* note 9, at 836 (citing RICHARD J. HILLMAN, U.S. GEN. ACCOUNTING OFFICE, TERRORISM INSURANCE: RISING UNINSURED EXPOSURE TO ATTACKS HEIGHTENS POTENTIAL ECONOMIC VULNERABILITIES 10 (2002)).

32. *Lack of Terrorism Risk Insurance Hearings*, *supra* note 29, at 53.

33. "Lenders will simply not provide financing for new or existing construction without certainty that the properties and businesses that they are funding have adequate insurance to protect the lenders' investment." H.R. REP. NO. 107-300, pt. 1, at 13 (2001).

34. See *Hearings*, *supra* note 27, at 66-71 (providing examples of cancellations and delays in construction projects attributed to the inability to find or afford adequate insurance).

35. Robert P. Hartwig, *September 11, 2001: The First Year*, at 13, at [http://server.iii.org/yy\\_obj\\_data/binary/693021\\_1\\_0/sept11paper.pdf](http://server.iii.org/yy_obj_data/binary/693021_1_0/sept11paper.pdf) (last visited Feb. 25, 2005).

36. See discussion *infra* Part VI.

damage<sup>37</sup> and marine war risks.<sup>38</sup> Though insurers agreed to cover the losses resulting from September 11,<sup>39</sup> multiple terrorist attacks of a “similar magnitude would call into question the solvency of the insurance industry.”<sup>40</sup> The federal government’s decision to implement the Terrorism Risk Insurance Act of 2002 (TRIA, or the Act) may have also been influenced by a sense of responsibility, because as one writer has posited: “The close interplay between the federal government’s foreign policy decisions and the existence of terrorist threats suggests that the federal government may be at least partly responsible for ‘creating’ many of the risks posed by terrorism.”<sup>41</sup>

#### IV. THE UNITED STATES GOVERNMENT AS A REINSURER OF LAST RESORT

##### A. *The Terrorism Risk Insurance Act of 2002*

TRIA was signed into law by President Bush on November 26, 2002, to “protect consumers by addressing market disruptions and ensure the continued widespread availability and affordability of property and casualty insurance for terrorism risk.”<sup>42</sup> TRIA established the Terrorism Insurance Program,<sup>43</sup> a temporary program set to sunset December 31, 2005.<sup>44</sup> Under TRIA, the federal government acts as a reinsurer for a three year period for acts of foreign terrorism<sup>45</sup> where property and casualty

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37. GRAYDON S. STARING, *LAW OF REINSURANCE* § 23.6, at 23-18 to -19 (2003).

38. *Id.*, at 23-19 (citing Harry L. Haehl, Jr., *The Hull Policy: Coverages and Exclusions Frequently Employed: F.C.& S., War Risk, S.R. & C.C., Automatic Termination, Cancellation*, 41 TUL. L. REV. 277, 283-84 (1967)).

39. H.R. REP. NO. 107-300, pt. 1, at 2 (2001).

40. Rizzo, *supra* note 20, at 13 (quoting *Hearing on America’s Insurance Industry: Keeping the Promise, Before the House Comm. on Fin. Servs.*, 107th Cong. 4 (2001) (statement of Dean R. O’Hare)).

41. Manns, *supra* note 30, at 2520.

42. Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, § 101(b)(1), 116 Stat. 2322, 2323 (2002).

43. *Id.* § 102(10), 116 Stat. at 2326.

44. *Id.* § 108(a), 116 Stat. at 2336.

45. See *id.* § 101(a)(6), 116 Stat. at 2323 (identifying one of TRIA’s goals as establishing the United States government as a subsidizer of a system “to create a viable financial services market for private terrorism insurance”). TRIA defines an “act of terrorism” as:

any act that is certified by the Secretary, in concurrence with the Secretary of

insurance losses from an act of terrorism exceed \$5,000,000.<sup>46</sup> Because TRIA only applies to acts of foreign terrorism,<sup>47</sup> events such as the 1995 Oklahoma City bombing would not be covered.<sup>48</sup> The Secretary of Treasury, Secretary of State, and United States Attorney General determine whether an event constitutes an act of terrorism, and this decision is final and not subject to judicial review.<sup>49</sup>

#### *B. Insurers, Availability, and Mandatory Participation*

Participation in TRIA is mandatory<sup>50</sup> in the sense that entities meeting the definition of an insurer<sup>51</sup> under the Act must make terrorism

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State, and the Attorney General of the United States—

- (i) to be an act of terrorism;
- (ii) to be a violent act or an act that is dangerous to—
  - (I) human life;
  - (II) property; or
  - (III) infrastructure;
- (iii) to have resulted in damage within the United States, or outside of the United States in the case of—
  - (I) an air carrier or vessel described in paragraph (5) (B); or
  - (II) the premises of a United States mission; and
- (iv) to have been 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 United States or to influence the policy or affect the conduct of the United States Government by coercion.

*Id.* § 102(1)(A), 116 Stat. at 2323-24.

46. *Id.* § 102(1)(B)(ii), 116 Stat. at 2324.

47. *Id.* § 102(1)(A), 116 Stat. at 2323.

48. Patricia Vowinkel, *Tackling a Burning Issue*, REINSURANCE MAG., Aug. 11, 2003, 36, 36.

49. Terrorism Risk Insurance Act § 102(1)(C), 116 Stat. at 2324.

50. *See id.* § 103(a)(3), 116 Stat. at 2327 (providing that all entities “meet[ing] the definition of an insurer under [TRIA] shall participate in the [Terrorism Insurance] Program”).

51. *Id.* § 102(6), 116 Stat. at 2325. An insurer is

any entity, including any affiliate thereof—

- (A) that is—

- (i) licensed or admitted to engage in the business of providing primary or excess insurance in any State;

coverage available.<sup>52</sup> Insurers participating in the program are required to pay a deductible based on direct earned premiums for the preceding calendar year, multiplied by a percentage that increases each year of the program's existence.<sup>53</sup> The Act also requires insurers to "make available

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- (ii) not licensed or admitted as described in the clause (i), if it is an eligible surplus line carrier listed on the Quarterly Listing of Alien Insurers of the NAIC, or any successor thereto;
- (iii) approved for the purpose of offering property and casualty insurance by a Federal agency in connection with maritime, energy or aviation activity;
- (iv) a State residual market insurance entity or State workers' compensation fund; or
- (v) any other entity described in section 103(f), to the extent provided in the rules of the Secretary issued under section 103(f);

(B) that receives direct earned premiums for any type of commercial property and casualty insurance coverage, other than in the case of entities described in sections 103(d) and 103(f); and

(C) that meets any other criteria that the Secretary may reasonably prescribe.

*Id.*, 116 Stat. at 2325.

52. *Id.* § 103(c)(1)(A), 116 Stat. at 2328.

53. *Id.* § 102(7), 116 Stat. at 2325. The statute provides:

The term insurer deductible means—

- (A) for the Transition Period, the value of an insurer's direct earned premiums over the calendar year immediately preceding the date of enactment of this Act, multiplied by 1 percent;
- (B) for Program Year 1, the value of an insurer's direct earned premiums over the calendar year immediately preceding Program Year 1, multiplied by 7 percent;
- (C) for Program Year 2, the value of an insurer's direct earned premiums over the calendar year immediately preceding Program Year 2, multiplied by 10 percent;
- (D) for Program Year 3, the value of the insurer's direct earned premiums over the calendar year immediately preceding Program Year 3, multiplied by 15 percent; and
- (E) notwithstanding subparagraphs (A) through (D), for the Transition Period, Program Year 1, Program Year 2, or Program Year 3, if an insurer has not had a full year of operations during the calendar year immediately preceding such Period or Program Year, such portion of the direct earned

property and casualty insurance coverage for insured losses that does not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism.”<sup>54</sup> Under the Act, states retain the ability to invalidate offered terrorism insurance rates “as excessive, inadequate, or unfairly discriminatory.”<sup>55</sup>

### *C. Shared Compensation and Annual Liability Caps*

TRIA provides that during the program years, the federal government will be responsible for 90% of the portion of insured losses that exceeds the insurer’s deductible that must be paid during each year of the program.<sup>56</sup> The federal government’s liability is capped under the Act at \$100 billion during the Transition Period<sup>57</sup> and during the first three Program Years of the Terrorism Insurance Program.<sup>58</sup> Where losses exceed \$100 billion, “the Secretary [of the Treasury] shall determine the pro rata share of insured losses to be paid by each insurer that incurs insured losses under the [Terrorism Insurance] Program.”<sup>59</sup> Duplicative compensation is not permitted under TRIA, and the amount of the federal government’s liability will “be reduced by the amount of compensation provided by the Federal Government to any person under any other Federal program for those insured losses.”<sup>60</sup>

In the event that the protections of TRIA are triggered, the federal government will recoup from insurers a portion of the federal share expended.<sup>61</sup> Recoupment includes a mandatory recoupment<sup>62</sup> and a broad

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premiums of the insurer as the Secretary determines appropriate, subject to appropriate methodologies established by the Secretary for measuring such direct earned premiums.

*Id.*

54. *Id.* § 103(c)(1)(B), 116 Stat. at 2328.

55. *Id.* § 106(a)(2)(B), 116 Stat. at 2334.

56. *Id.* § 103(e)(1)(A), 116 Stat. at 2328.

57. *Id.* § 102(11)(A), 116 Stat. at 2326 (defining the Transition Period as the period between TRIA’s enactment and December 31, 2002).

58. *Id.* § 103(e)(2)(A), 116 Stat. at 2328-29; *see also id.* § 102(11)(B)-(D), 116 Stat. at 2326 (defining the Program Years and establishing the timetable for the Terrorism Insurance Program’s existence).

59. *Id.* § 103(e)(2)(B), 116 Stat. at 2329.

60. *Id.* § 103(e)(1)(B), 116 Stat. at 2328.

61. *Id.* § 103(e)(7)(A), 116 Stat. at 2329.

62. Mandatory recoupment is

the difference between—

discretionary recoupment power that may be exercised by the Secretary of the Treasury.<sup>63</sup> However, the discretionary recoupment amount “may not exceed, on an annual basis, the amount equal to 3 percent of the premium charged for property and casualty insurance coverage under the policy.”<sup>64</sup> The Act also caps insurer liability, specifying that “no insurer that has met its insurer deductible shall be liable for the payment of any portion of that amount that exceeds \$100,000,000,000.”<sup>65</sup>

#### *D. Pre-existing Terrorism Exclusions*

Under TRIA, existing terrorism exclusions in property and casualty insurance contracts are declared void, including any state-approved terrorism exclusions.<sup>66</sup> However, insurers may reinstate preexisting terrorism exclusions in property and casualty insurance contracts if the insured affirmatively authorizes the reinstatement of the terrorism exclusion in a written statement.<sup>67</sup> Exclusions may also be reinstated if “the insurer fails to pay any increased premium charged by the insurer for providing such terrorism coverage; and . . . the insurer provided notice, at least 30 days before any such reinstatement” of increased premiums for terrorism coverage and information regarding the rights of the insured under such coverage, “including any date upon which the exclusion would be reinstated if no payment is received.”<sup>68</sup>

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(i) the insurance marketplace aggregate retention amount under paragraph (6) for such period; and

(ii) the aggregate amount, for all insurers, of insured losses during such period that are not compensated by the Federal Government because such losses—

(I) are within the insurer deductible for the insurer subject to the losses; or

(II) are within the portion of losses of the insurer that exceed the insurer deductible, but are not compensated pursuant to paragraph (1) [referring to compensation from other federal programs].

*Id.*

63. *See id.* § 103(e)(7)(D), 116 Stat. at 2330 (“To the extent that the amount of Federal financial assistance provided exceeds any mandatory recoupment amount, the Secretary [of the Treasury] may recoup, through terrorism loss risk-spreading premiums, such additional amounts that the Secretary believes can be recouped . . .”).

64. *Id.* § 103(e)(8)(C), 116 Stat. at 2330-31.

65. *Id.* § 103(e)(2)(A)(ii), 116 Stat. at 2329.

66. *Id.* § 105(a), (b), 116 Stat. at 2334.

67. *Id.* § 105(c)(1), 116 Stat. at 2334.

68. *Id.* § 105(c)(2), 116 Stat. at 2334.

### E. An Exclusive Cause of Action

TRIA preempts state actions and creates an exclusive “Federal cause of action for property damage, personal injury, or death arising out of” acts of terrorism as defined and declared under the Act.<sup>69</sup> After an event has been declared an act of terrorism, a single district court, or more if necessary, will be designated to have original and exclusive jurisdiction to hear claims “relating to or arising out of” the designated act of terrorism.<sup>70</sup> The Act also specifies that punitive damages that may be awarded will not be counted as insured losses.<sup>71</sup>

## V. RESPONSE TO THE TERRORISM RISK INSURANCE ACT

### A. Mixed Reviews

TRIA, though never tested, has received mixed reviews. Upon signing TRIA into law, President Bush praised the Act, citing the need for affordable and available terrorism insurance in order to move construction projects forward and to spur economic growth.<sup>72</sup> Citing the importance of market investors’ confidence in the strength of the economy to withstand a future attack, President Bush proclaimed, “we’re defending America by making our economy more secure.”<sup>73</sup>

Though the insurance industry moved for the federal government’s involvement, insurers have expressed concerns, noting that under TRIA insurers have been forced to take on more risk.<sup>74</sup> While the insurance industry was able to reduce its exposure to acts of terrorism by choosing to implement exclusions after September 11, 2001, under TRIA, insurers are required to make terrorism coverage available.<sup>75</sup> Insurers are left with no choice but to offer terrorism insurance because the requirement to provide coverage for acts of terrorism is not excused by choosing not to accept help from the government.<sup>76</sup>

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69. *Id.* § 107(a)(1)-(2), 116 Stat. at 2335.

70. *Id.* § 107(a)(4), 116 Stat. at 2335.

71. *Id.* § 107(a)(5), 116 Stat. at 2335.

72. Statement by President George W. Bush Upon Signing H.R. 3210, 2002 U.S.C.C.A.N. 1436, 1436.

73. *Id.* at 1438.

74. Allyn & McNeff, *supra* note 9, at 842 (citing Janina Clark, *US Terror Bill Slows Renewals*, REINSURANCE MAG., Dec. 2002/Jan. 2003, at 1, 1).

75. *Id.*

76. *Backstop Blues*, REINSURANCE MAG., Feb. 2003, at 29, 29.

Another insurance industry objection to TRIA is that deductibles are too high, especially in the later stages of the Terrorism Insurance Program.<sup>77</sup> These insurers describe the deductible requirements as “more positive for the industry in the first year than in the second and third year[s].”<sup>78</sup> Furthermore, although the goal of TRIA was to make terrorism insurance affordable and available, the premiums charged are substantial, which has been cited as a primary factor for the low take-up rates of the terrorism insurance coverage offered under TRIA.<sup>79</sup>

Other critics of the Act expressed views before its passage about the potential for an economic moral hazard.<sup>80</sup> “A moral hazard is created when individuals have the costs incurred from a risky action subsidized by a third party. In such a case individuals may engage in unnecessary risks or fail to take steps to minimize their risks.”<sup>81</sup> A dissenter claimed TRIA provides no incentive for private parties to enhance security or mitigate damages to prevent future terrorist attacks.<sup>82</sup> Therefore, the Act could have the unintended effect of increasing damage and loss suffered in future terrorist attacks.<sup>83</sup> However, moral hazards may be limited because “[i]nsured parties would still be concerned about the severe risks to human life posed by terrorist threats, [and insured parties may] face risks of continued exposure to uncompensated punitive damages for negligence if they fail to adopt precautions.”<sup>84</sup>

Critics view government intervention as unnecessary, citing the likelihood that the private insurance industry would have eventually found a solution for the problem on its own.<sup>85</sup> “The problems arising from a temporary capacity shortage and associated complications are short-term

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77. Allyn & McNeff, *supra* note 9, at 842 (citing Michael Ha, *Insurers Scrambling to Comply with New Terrorism Insurance Law*, NAT'L UNDERWRITER PROP. & CAS. RISK & BENEFITS MGMT., Dec. 2, 2002, at 5).

78. *Id.* (citing Ha, *supra* note 77, at 5).

79. John P. Dearie & Laurie A. Kamaiko, *Terrorism Risk Statute*, NAT'L L.J., July 21, 2003, at 17.

80. H.R. REP. NO. 107-300, pt. 1, at 52 (2001).

81. *Id.* (quoting Ha, *supra* note 77, at 5) (alteration in original).

82. *Id.* at 52-53.

83. *Id.* at 53.

84. Manns, *supra* note 30, at 2537 (citing RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 9-11, 207 (4th ed. 1992)).

85. See Anne Gron & Alan O. Sykes, *Terrorism and Insurance Markets: A Role for the Government as Insurer?*, 23 IND. L. REV. 447, 448-49 (2003) (discussing that the insurance market over time, absent new shocks, would have improved substantially the level of availability and more affordable pricing).

and can be expected to be self-correcting.”<sup>86</sup> Because the government stepped in to regulate the terrorism insurance market, critics surmise that the assigned rates may discourage or prevent the emergence of efficient private terrorism insurance programs and improved risk sharing.<sup>87</sup>

#### B. Any Takers?

Supporters say TRIA has enabled trophy properties such as the Empire State Building in New York City and the Sears Tower in Chicago to purchase terrorism insurance.<sup>88</sup> Damian R. Testa, president of Kaye Insurance Associates, states that TRIA has been successful in New York, citing that “[t]he cost of terrorism insurance is about 20% of property premiums now, having fallen dramatically from a year ago, when it was almost equal to the property premium.”<sup>89</sup> Though terrorism coverage is more widely available since the passage of TRIA, a survey by the Council of Insurance Agents and Brokers concludes that 72% of brokers indicated that their customers were not purchasing terrorism insurance.<sup>90</sup> Industry estimates indicate that terrorism coverage purchasers for “commercial property and liability lines is as low as one in five businesses, though some individual carriers report much higher rates depending on business class.”<sup>91</sup>

Policyholders are citing many reasons for deciding not to purchase terrorism insurance coverage under the Act. The high cost of terrorism coverage, the failure of policies to cover domestic acts of terrorism, and possible terrorist attacks employing nuclear, biological, or chemical weapons are primary reasons cited for rejecting terrorism insurance coverage.<sup>92</sup> Stand-alone terrorism insurance is preferred by many large companies because domestic acts of terrorism and incidents involving biochemical agents are often covered.<sup>93</sup> The simple lack of belief that terrorism will strike their business or property and the hope that the

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86. *Id.* at 448.

87. *See id.* at 449-50 (arguing that when the government enters the insurance market, insurance is often priced improperly and could crowd out more efficient private insurance).

88. *See* Meg Green, *A Glass Half Full*, BEST’S REV., Sept. 2003, at 50, 50 (citing the availability of terrorism coverage for the Empire State Building in New York City and the Sears Tower in Chicago after the implementation of TRIA as evidence that the Act is not only working, but was necessary).

89. *Id.* at 51.

90. *Id.* at 50.

91. *Id.*

92. Dearie & Kamaiko, *supra* note 79, at 17.

93. *Id.*

government will step in and pay resulting losses from future acts of terrorism are also reasons some policyholders have opted against purchasing terrorism insurance though it has been made available.<sup>94</sup>

### C. A Temporary Act?

TRIA was created as a temporary, three-year program designed to stabilize the United States economy during a national economic crisis.<sup>95</sup> A short-term approach has been preferred by some because, “over time the market will unfreeze—premiums for terror coverage will be priced and capital will return.”<sup>96</sup> Though treasury officials have warned insurance industry members not to assume that TRIA will be renewed,<sup>97</sup> others anticipate that irresistible political pressures may keep the temporary program in existence.<sup>98</sup> Speculation has been raised that this program will likely be renewed because many long-lasting programs were originally created as temporary programs.<sup>99</sup> Jeffrey Bragg, the Terrorism Risk Insurance Program Executive Director, anticipated these arguments and noted that “the Former Riot Reinsurance Program and the Former Federal Crime Insurance Program are [two] examples of government insurance mechanisms that have been discontinued when it became clear that their temporary mission had been fulfilled.”<sup>100</sup> However, three months earlier at the National Council on Compensation Insurance’s Annual Issues Symposium, Bragg indicated that the program may not sunset in 2005 and asked the crowd rhetorically, “[h]ow many of you are aware of any federal program that was terminated?”<sup>101</sup> Under TRIA, the Secretary of Treasury must conduct a study and submit a report to Congress no later than June 30, 2005 to assess the effectiveness of the Act, which will likely determine if

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94. *Id.*

95. Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, § 101(b)(1)-(2), 116 Stat. 2322, 2323 (2002) (stating the purpose of the Act); *id.* § 108(a), 116 Stat. at 2336 (stating the program will terminate on December 31, 2005).

96. Stempel, *supra* note 19, at 868 (citing Editorial, *Ensuring Insurance*, WALL ST. J., Oct. 24, 2001, at A22).

97. Dearie & Kamaiko, *supra* note 79, at 17.

98. Gron & Sykes, *supra* note 85, at 450.

99. See H.R. REP. NO. 107-300, pt. 1, at 52 (2001) (“Does anyone seriously believe that Congress will fail to reauthorize this ‘temporary’ insurance program or provide some other form of taxpayer help to the insurance industry? My colleagues should remember that the federal budget is full of expenditures for long-lasting programs that were originally intended to be ‘temporary.’”).

100. *Presentation*, *supra* note 16, available at 2003 WL 21910591, at \*2.

101. *Issue Is New World of American Insurance Industry: Can Terrorism Be Underwritten?*, WORKERS’ COMP. EXECUTIVE, May 21, 2003, at 3.

the Act should be renewed.<sup>102</sup> Therefore, it is likely only time will tell whether the Act will be renewed before the Act sunsets December 31, 2005.

## VI. TERRORISM INSURANCE COVERAGE IN EUROPE AND POST-SEPTEMBER 11 TERRORISM POOLS

Though terrorism did not spread to the United States until much later, major European countries have been plagued by terrorism for decades.<sup>103</sup> Prior to September 11, 2001, terrorism insurance coverage in the United States "was effectively given away for free with property and business interruption insurance."<sup>104</sup> However, attempted terrorism exclusions have been an issue for many years in European countries,<sup>105</sup> prompting some governments to step in to address the lack of coverage.<sup>106</sup>

Following the events of September 11, the United States looked to European terrorism pools as models when creating TRIA.<sup>107</sup> Notably, no two European terrorism coverage solutions are identical, despite the European Union's goal of harmonization and convergence.<sup>108</sup> Therefore,

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102. Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, § 108(d)(1), 116 Stat. 2322, 2336 (2002). The Act states:

The Secretary [of the Treasury], in consultation with the NAIC, representatives of the insurance industry and of policy holders, other experts in the insurance field, and other experts as needed, shall assess the effectiveness of the [Terrorism Insurance] Program and the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the Program, and the availability and affordability of such insurance for various policyholders, including railroads, trucking, and public transit.

*Id.*

103. See PARTNERRE, TERRORISM INSURANCE—POOLS & MARKET SOLUTIONS IN EUROPE 3 (May 2004) (noting that while terrorism eventually spread to the United States, several major European countries felt the effects of terrorism following World War II), *at* <http://www.partnerre.com/pdf/TerrorismInsurance.pdf> (last visited Feb. 25, 2005).

104. Adrian Leonard, *European Insurance: Home-Market Boundaries Have Melted Away*, *at* <http://www.businessweek.com/adsections/2002/euinsurance/euinsurance2.htm> (last visited Feb. 25, 2005).

105. *See id.*

106. *See infra* Parts VII-IX.

107. *See, e.g.*, H.R. REP. NO. 107-300, pt. 2, at 15-16 (2001) (discussing, among other government-backed programs, Pool Re, "the government-backed insurance pool that spreads the risk of terrorist acts among insurers in the United Kingdom").

108. PARTNERRE, *supra* note 103, at 5.

the variety of solutions at work throughout Europe, in existence both before and after September 11, are instructive models and may enable an enhanced understanding of the strengths and weaknesses of TRIA, while providing possible alternatives and insights for 2005 when TRIA is set to sunset.

Though terrorism pools have been in place in various European countries for many years,<sup>109</sup> the events of September 11 prompted other countries to address terrorism insurance issues.<sup>110</sup> The events of September 11 made apparent the vulnerability of the German insurance industry and the need for government involvement, prompting the German government to create Extremus Versicherungs-AG on September 3, 2002.<sup>111</sup> Under Extremus, “[a]bout 50 domestic and foreign insurers and reinsurers cover damages caused by acts of terrorism up to €3 billion [for damage to risks located in Federal Republic of Germany], while the German government is liable for up to €10 billion where annual aggregate losses are in excess of €3 billion.”<sup>112</sup> Extremus, a program with limited state involvement,<sup>113</sup> provides coverage for “property damage and losses arising from business interruption” and excludes “[a]tomic and nuclear energy risks.”<sup>114</sup>

Though prior to the events of September 11 Austria did not consider itself personally threatened by terrorism, the Österreichischer Versicherungspool zur Deckung von Terrorrisiken was created on October 1, 2002.<sup>115</sup> This voluntary pool is comprised of about 99% of the Austrian insurance association members, and covers “property damage and business interruption arising from terrorism up to a maximum limit of €5 million per policy/location without additional premium and accepts industrial, commercial, as well as private risks.”<sup>116</sup> The Austrian pool excludes biological and chemical contamination damages.<sup>117</sup>

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109. See *id.* at 3 (discussing Spain’s Consorcio, created in 1941, and Pool Re, created in 1993).

110. *Id.* at 4.

111. AON, *Terrorism Insurance and Reinsurance Solutions: A Revolution in Europe* 10, at [http://www.aon.com/about/publications/pdf/issues/arw\\_terrorism\\_europe.pdf](http://www.aon.com/about/publications/pdf/issues/arw_terrorism_europe.pdf) (last visited Feb. 25, 2005).

112. *Id.*

113. See *id.* (“Extremus cedes the business written in full to reinsurers.”).

114. *Id.* at 10, 11.

115. *Id.* at 7.

116. *Id.*

117. *Id.*

## VII. SPAIN'S CONSORCIO: EUROPE'S OLDEST TERRORISM POOL

The Spanish Consorcio de Compensación de Seguros (hereinafter Consorcio) is Europe's oldest national terrorism pool.<sup>118</sup> Consorcio was created in 1941 in an effort to manage indemnities resulting from the Spanish Civil War.<sup>119</sup> In 1954, Consorcio obtained permanent legal status when mandatory coverage for catastrophic risk,<sup>120</sup> including acts of terrorism,<sup>121</sup> was implemented "within all policies covering property damage and bodily injury in the lines of business defined by law."<sup>122</sup> Though Consorcio is the oldest terrorism pool in Europe, the unlimited government-backed warranty has never been triggered.<sup>123</sup>

Unlike many terrorism pools implemented to provide reinsurance alternatives, Consorcio directly insures extraordinary risks.<sup>124</sup> An unlimited state guarantee supports Consorcio, enabling the pool to directly insure extraordinary risks.<sup>125</sup> The compulsory coverage provided by Consorcio covers fires and perils, theft, glass, machinery breakdown, and civil works.<sup>126</sup>

Even the world's oldest terrorism pool was affected by the events of September 11.<sup>127</sup> After reinsurance became scarce following the events of September 11, Consorcio agreed to reinsurance business interruption that resulted from acts of terrorism, coverage which had previously been denied under existing extraordinary risk coverage.<sup>128</sup> As of January 2002, business interruption damages resulting from acts of terrorism or other extraordinary risks are covered by Consorcio.<sup>129</sup>

Exactly two and a half years after the devastating international

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118. PARTNERRE, *supra* note 103, at 3.

119. *Id.*

120. AON, *supra* note 111, at 16.

121. PARTNERRE, *supra* note 103, at 8. "Terrorism is defined as 'any violent action with the aim to destabilise the established political system or cause fear and insecurity within the groups of people who are targeted.'" *Id.*

122. AON, *supra* note 111, at 16.

123. PARTNERRE, *supra* note 103, at 8.

124. *Id.*

125. *Id.*

126. AON, *supra* note 111, at 17.

127. As a result of a 2004 amendment, "the Consorcio now covers all Property policies for the vast majority of catastrophe risks without need of the international reinsurance market." PARTNERRE, *supra* note 103, at 9.

128. AON, *supra* note 111, at 16.

129. PARTNERRE, *supra* note 103, at 9.

terrorist attacks perpetrated on September 11, 2001, Spain experienced “the worst terrorist attack in modern Spanish history.”<sup>130</sup> The train bombings that took place in Madrid caused at least 190 deaths and wounded nearly 1,500 others.<sup>131</sup> Backpacks containing explosives caused 10 nearly simultaneous explosions, inflicting devastating damage on 4 packed commuter trains during rush hour, after the backpacks were left on the tracks at 3 stations and aboard trains.<sup>132</sup> A total of 68 suspects have been arrested in connection with the bombing and the Spanish government blames an Islamic group aligned with al-Qaeda.<sup>133</sup> Because terrorism is an ever-present threat in today’s world, Spain is at least prepared for severe damage resulting from terrorism because of their extraordinary risk insurance coverage.

### VIII. THE UNITED KINGDOM: NO STRANGER TO TERRORISM

The United Kingdom is no stranger to acts of terrorism and the necessity of terrorism insurance coverage. In 1992, for example, bombs blasted throughout England as a result of the Irish Republican Army’s terrorist campaign of “economic disruption.”<sup>134</sup> In April of 1992, a bombing at St. Mary’s Axe, located in London’s financial district, caused an estimated £350 million in damage.<sup>135</sup> As a result of the bombings and destruction throughout England, continental reinsurers,<sup>136</sup> followed by British reinsurers,<sup>137</sup> announced that beginning January 1, 1993, terrorism coverage would be excluded from reinsurance treaties.<sup>138</sup> As a result of the unavailability of reinsurance,<sup>139</sup> almost all British direct insurers announced they would implement terrorism exclusions into their commercial property

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130. Keith B. Richburg, *Madrid Train Blasts Kill at Least 190*, WASH. POST, Mar. 12, 2004, at A1.

131. *Id.*

132. *Id.*

133. *Analysis: Madrid Terror Probe*, at <http://news.bbc.co.uk/1/hi/world/europe/3647508.stm> (Nov. 16, 2004).

134. William B. Bice, *British Government Reinsurance and Acts of Terrorism: The Problems of Pool Re*, 15 U. PA. J. INT’L BUS. L. 441, 446 (1994) (citing Editorial, *Insuring Against Terror*, THE ECONOMIST, Dec. 12, 1992, at 19, 19).

135. *Id.* (citing *Crying Wolf?*, WORLD INS. REP., Mar. 12, 1993, at 1, 1).

136. *Id.* at 446-47.

137. *Id.* at 447 (citing Stacy Shapiro, *U.K. Reinsurers Exclude Terrorist Acts*, BUS. INS., Nov. 23, 1992, at 53, 53).

138. *Id.* (citing Fiona Gibson, *Will Insurance Be Terror’s Next Victim?*, LLOYDS INS. INT’L, Dec. 1, 1992, at 1, 1).

139. *Id.* (citing Gibson, *supra* note 138, at 2).

insurance policies “covering material damage and subsequent consequential loss.”<sup>140</sup>

The implementation of terrorism exclusions into commercial property insurance policies threatened to disrupt British commerce and industry due to lack of coverage availability in Great Britain,<sup>141</sup> consequences the United States faced nearly nine years later following the events of September 11.<sup>142</sup> The threat of economic crisis was present and the British feared the collapse of the real estate market<sup>143</sup> and widespread business bankruptcy in the event of subsequent terrorist activity.<sup>144</sup> Concerns were also raised that property development may be stunted if developers were unable to secure financing.<sup>145</sup>

#### *A. Answering the Call for Government Intervention*

As a result of the potential economic crisis that threatened Great Britain, the Pool Reinsurance Company Limited (Pool Re) was created in 1993.<sup>146</sup> Under the Reinsurance (Acts of Terrorism) Act of 1993,<sup>147</sup> the British government agreed to act as a reinsurer for damage to property located in the United Kingdom resulting from acts of terrorism.<sup>148</sup> Pool Re is a “mutual reinsurance company authori[z]ed to transact reinsurance business for commercial property and business interruption.”<sup>149</sup> According to the Department of Trade and Industry, the government’s objective in creating Pool Re was “to incur a zero cost to [the] Government over a period of years and to enable the insurance market to function as normally

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140. Nicholas Munday, *UK Commercial Property Insurance: Terrorism Pool Put to the Test*, 1 INT’L INS. L. REV. 124, 128 (1993).

141. AON, *supra* note 111, at 12.

142. *See supra* Part III.A.

143. Bice, *supra* note 134, at 448 (citing Christopher Mayer, *End of Terror Cover Sparks Crisis Fears*, LLOYDS LIST, Dec. 14, 1992, at 10, 10).

144. *Id.* (citing Gibson, *supra* note 138, at 2).

145. *Id.* (citing Gibson, *supra* note 138, at 2).

146. *See AON, supra* note 111, at 12 (citing the threat to commerce and industry that resulted from the lack of terrorism coverage as reasons for the creation of Pool Re).

147. Reinsurance (Acts of Terrorism) Act, 1993, c. 18 (Eng.), available at [http://www.hmso.gov.uk/acts/acts1993/Ukpga\\_19930018\\_en\\_1.htm](http://www.hmso.gov.uk/acts/acts1993/Ukpga_19930018_en_1.htm).

148. *See id.* § 2 (“[A]cts of terrorism’ means acts of persons acting on behalf of, or in connection with, any organization which carries out activities directed towards the overthrowing or influencing, by force or violence, of Her Majesty’s government in the United Kingdom or any other government de jure or de facto.”). The Act does not extend to Northern Ireland where separate arrangements are in place. *Id.* § 3.

149. PARTNERRE, *supra* note 103, at 11.

as possible so that the need for Government intervention will become increasingly removed over time.”<sup>150</sup>

In July of 1993, “Pool Re entered into a retrocession agreement with the Secretary of State for Trade [and] Industry, under which the government pays [Pool Re] for claims that exceed its resources and receives a premium for the cover provided.”<sup>151</sup> The British government therefore acts as a reinsurer of last resort for Pool Re, which reinsurance its own member insurers.<sup>152</sup> Though policyholders will be thoroughly safeguarded, the total protection is comprised of 5 distinct layers, with the British government providing coverage only as a last resort.<sup>153</sup>

The first layer of protection is deductible on the insured’s underlying policy.<sup>154</sup> “Any losses claimed by a policyholder due to a terrorist attack that do not exceed the £100,000 limit per policy section will be borne entirely by the insurer with no reimbursement from the government-guaranteed Pool Re system.”<sup>155</sup> Only if loss from an act of terrorism exceeds £100,000 will Pool Re funds be called upon for coverage.<sup>156</sup> Premiums are collected from Pool Re members, and Pool Re pays 100% of losses suffered by insurers resulting from a terrorist attack after a deductible.<sup>157</sup> The British government will only be liable in the event that claims resulting from an act of terrorism exhaust Pool Re’s resources.<sup>158</sup> In the event that claimed losses exhaust Pool Re’s resources, “an additional ten percent ‘call’ [of a member’s annual premiums] is levied on the member insurers in the pool.”<sup>159</sup> Therefore, the British government is only liable as the reinsurer of last resort for losses exceeding 110% of Pool Re’s total funds.<sup>160</sup> The unlimited state guarantee has never been triggered.<sup>161</sup>

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150. Nicholas Munday & Clifford Chance, *Reinsurance (Acts of Terrorism) Act of 1993*, 1 INT’L INS. L. REV. 688, 689 (1993).

151. AON, *supra* note 111, at 12.

152. See Bice, *supra* note 134, at 453 (concluding that “[i]f Pool Re . . . is exhausted because of a terrorist attack, the British government ultimately is liable for all losses in excess of that amount”).

153. Munday, *supra* note 140, at 128-29.

154. *Id.* at 128.

155. See Bice, *supra* note 134, at 449-50 (citing William Gloyn, *Insurance Against Terrorism*, L. SOC’Y GAZETTE, June 9, 1993, at 20, 24).

156. Munday, *supra* note 140, at 128.

157. H.R. REP. NO. 107-300, pt. 2, at 16 (2001).

158. *Id.*

159. Bice, *supra* note 134, at 453.

160. *See id.*

161. AON, *supra* note 111, at 12.

### B. Pool Re Membership and Premium Setting

Membership and participation in Pool Re is optional<sup>162</sup> for insurers.<sup>163</sup> Pool Re emerged in 1993 with “129 [i]nsurance [c]ompanies and 88 Lloyd’s syndicates” listed as members.<sup>164</sup> As of March 22, 2002, “Pool Re had 224 members, including 40 Lloyd’s syndicates, 100 insurance companies incorporated in the UK and 84 insurance companies incorporated in other countries.”<sup>165</sup>

Since its creation in 1993, Pool Re has used several factors in determining premiums charged to members. The first factor in determining the premium amount is the total value of all properties to be insured, including property of any subsidiary companies.<sup>166</sup> In order to become a member of Pool Re, however, a company must purchase the additional Pool Re coverage for all properties.<sup>167</sup> This requirement ensures diversification of the pool and prevents adverse selection.<sup>168</sup> The second factor is the location of the at-risk property. By dividing the British mainland into two zones, Pool Re charges higher rates for high-risk areas such as London and other cities’ commercial districts.<sup>169</sup> The rates collected in these high-risk areas are approximately three to five times the rates collected for the lower risk areas of Great Britain.<sup>170</sup>

The third premium factor is an evaluation of the target risk of an area that requires “rate setting personnel [to] determine whether and to what extent a particular property is at risk of terrorist attack.”<sup>171</sup> The final factor in creation of the premium is a 3% levy attached by the British government “on all household and motor vehicle policies written in Great Britain.”<sup>172</sup>

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162. Manns, *supra* note 30, at 2512 n.22.

163. See PARTNERRE, *supra* note 103, at 12 (“Any insurance company or Lloyd’s syndicate that is authorised either by the UK or an overseas regulatory authority to transact property insurance in the UK is eligible to be a Member of Pool Re.”).

164. David Lewis, *Provisions of Terrorism and Riot Coverage in Different Countries*, at <http://astre.scor.com/astrehelp/en/Assur/inc/extensionuk/terrorism.htm> (Aug. 26, 2002).

165. AON, *supra* note 111, at 12.

166. Bice, *supra* note 134, at 451 (citing Gloyn, *supra* note 155, at 24).

167. Munday, *supra* note 140, at 129.

168. AON, *supra* note 111, at 12.

169. Bice, *supra* note 134, at 452 (citing Gloyn, *supra* note 155, at 25).

170. *Id.* (citing Gloyn, *supra* note 155, at 25).

171. *Id.*

172. *Id.* (citing Jonathan Prynne, *IRA Blamed for Tax on Insurance Premiums*, THE TIMES (London), Dec. 11, 1993, at 2).

High-risk and target area policyholders located in London thus benefit from this levy at the expense of other insureds who object to providing insurance coverage for London's business district.<sup>173</sup>

### C. Criticism of Pool Re

Those concerned with the economic impact of terrorism that threatened the British economy in 1993 were likely relieved when the government stepped forward to act as a reinsurer of last resort. In 1993, upon entering into the reinsurance agreements, "the U.K. Government made clear its intention to withdraw from the arrangement when the insurance market is able to provide Terrorism Cover without the requirement for Government support."<sup>174</sup> However, critics within the private insurance community viewed the government backstop as the "first step in an eventual government takeover of the industry."<sup>175</sup> Furthermore, profits collected by the British government are "lost to the insurance industry."<sup>176</sup>

Critics also argued that a self-sufficient Pool Re without the government acting as the reinsurer of last resort is unlikely, because Pool Re members and direct insurers have no incentive to cover potential losses by increasing premiums and offering their own terrorism coverage.<sup>177</sup> Therefore, critics argue, because the British government agreed to act as a reinsurer of last resort, prospective competitors and companies that may have stepped forward to underwrite terrorism insurance had no incentive to compete with the British government.<sup>178</sup>

Since Pool Re's inception, the exorbitant price of additional terrorism coverage has been noted as a primary flaw of the system.<sup>179</sup> As a result, many property owners have chosen not to purchase additional terrorism coverage, which may pose a devastating threat to the British economy.<sup>180</sup> Critics have also cited a moral hazard within Pool Re because companies are given no incentives by Pool Re to minimize their risk of becoming

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173. *Id.* at 452-53.

174. PARTNERRE, *supra* note 103, at 12-13.

175. Bice, *supra* note 134, at 458 (citing Maria Kielmas, *Terrorism Losses Spark Debate over Responsibility*, BUS. INS., July 12, 1993, at 19, 19).

176. *Id.* at 457 (citation omitted).

177. *Id.* at 462 (citing Gavin Souter, *U.K. Terrorism Coverage Plan Criticized*, BUS. INS., June 28, 1993, at 13, 13).

178. *Id.* at 456 (citing Gloyn, *supra* note 155, at 20, 23).

179. *Id.* at 458.

180. Munday, *supra* note 140, at 129.

targets of terrorist attacks.<sup>181</sup>

#### D. *Pool Re: Post-September 11*

The events of September 11 that shocked the United States' economy and raised Americans' consciousness of terrorist activity<sup>182</sup> also affected the British insurance market.<sup>183</sup> Post-September 11 amendments to Pool Re, however, addressed some issues that had plagued the program since its inception. Pool Re had previously been criticized because each insurer's potential exposure was unknown.<sup>184</sup> Though there was an immediate £100,000 exposure to the direct insurer, multiple claims due to one terrorist attack could lead to multiple £100,000 payments.<sup>185</sup> Under the amendments implemented January 1, 2003, members will be "subject to a maximum loss retention per event per Member . . . combined with an annual aggregate limit. The amount of the retentions are based on the degree of Members' participation in the Pool Re scheme."<sup>186</sup> Therefore, members will know in advance their maximum liability each year under the amended program.<sup>187</sup> As a result of the amendments, members who contribute a greater portion of the market share, and therefore contribute greater risk, will bear higher retentions and liability.<sup>188</sup> The criticized zone-based rate calculation for reinsurance rate calculations will, however, remain intact.<sup>189</sup>

Direct insurers are also "free to set their own terrorism premiums for their underlying policies, according to normal commercial arrangements"<sup>190</sup> and Pool Re will continue to reinsure terrorism risks.<sup>191</sup> This amendment does away with the Pool Re rate specifications for insurer members to

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181. Bice, *supra* note 134, at 459.

182. See discussion *supra* Parts I-II.

183. See, e.g., Christine Selb, *Cost of Terrorist Attack Insurance Falls by Half*, THE TIMES (London), July 31, 2003, at 25 (reporting that terrorism coverage costs soared up to 400 % following the September 11, 2001 terrorist attack on the United States).

184. Adam Levitt & Hammad Akhtar, *From Cover to Cover*, EST. GAZETTE, Apr. 12, 2003, at 134.

185. *Id.*

186. PARTNERRE, *supra* note 103, at 12-13. The degree of a Member's participation is determined by its market share. *Id.* at 13.

187. Levitt & Akhtar, *supra* note 184, at 134. "For 2003, the minimum level in the annual aggregate is £200,000, and per event it is £100,000." *Id.*

188. *Id.*

189. *Id.*

190. PARTNERRE, *supra* note 103, at 13.

191. Levitt & Akhtar, *supra* note 184, at 134.

charge insureds. Furthermore, this will hopefully be a positive change for insureds who may reap the benefit of competition between insurers.<sup>192</sup> Because Pool Re will still be available to reinsure direct insurer's terrorism risks, insureds may hope to gain more comprehensive terrorism coverage.<sup>193</sup>

Another Pool Re amendment that surpasses the terrorism reinsurance coverage provided by TRIA<sup>194</sup> is the deletion of the previously existing nuclear exclusion to reinsurance of all risks.<sup>195</sup> When Pool Re was established in 1993, cover was "restricted to Acts of Terrorism resulting in fire and/or explosion only."<sup>196</sup> Pool Re premiums have, however, doubled due to the more comprehensive coverage made possible by the amendments, which has raised concerns that property "owners may choose not to insure against terrorism risks."<sup>197</sup> Under the amendments, Pool Re has also discontinued the practice of collecting additional premiums from members in years "that result in a[n] [underwriting] loss," and members will no longer be entitled to premium rebates in years where Pool Re realizes an underwriting profit.<sup>198</sup>

#### E. Alternatives Emerge

Though September 11 changed the United Kingdom's insurance market overnight,<sup>199</sup> alternative insurance coverage surfaced in the summer of 2003 and the cost of terrorism insurance plunged 50% for insuring London's most prestigious buildings.<sup>200</sup> Lloyd's of London's insurers undercut Pool Re premiums, leading to terrorism insurance coverage at a lower cost.<sup>201</sup> As a result, terrorism coverage was the cheapest it had been since September 11.<sup>202</sup> The insurance coverage offered by Lloyd's of London may also benefit owners of London's most prestigious buildings who only want to insure high-risk properties, which is impermissible under

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192. *Id.*

193. *Id.*

194. See discussion *supra* Part V.B.

195. PARTNERRE, *supra* note 103, at 12 (stating that "the only excluded losses [after January 2003 will be for] war and related perils and computer hacking, [and] virus and denial of service attack").

196. *Id.*

197. Levitt & Akhtar, *supra* note 184, at 134.

198. AON, *supra* note 111, at 14.

199. See discussion *supra* Part VIII.D (outlining amendments to Pool Re).

200. Selb, *supra* note 183, at 25.

201. *Id.*

202. *Id.*

Pool Re's risk-spreading requirement.<sup>203</sup> Likely as a result of the 2003 amendments to Pool Re, alternative terrorism insurance has emerged that may benefit consumers seeking to insure their commercial properties against terrorist attacks.<sup>204</sup>

## IX. FRANCE: A LEGISLATIVE SOLUTION

### A. *Mandatory Terrorism Coverage*

The French have also endured terrorism on their soil.<sup>205</sup> Terrorism insurance coverage has been a concern in France since 1982.<sup>206</sup> In 1982, the French government facilitated terrorism insurance availability at a national level by passing legislation allowing the Caisse Centrale de Réassurance (CCR) to reinsure terrorism coverage with an active government guarantee of coverage.<sup>207</sup> In 1986, compulsory terrorism coverage was mandated for all property insurance policies when waves of terrorist attacks increased in frequency.<sup>208</sup> A subsequent decree in 1987 added that "the terrorist cover deductible could not be different from the property deductible."<sup>209</sup> However, competition in the 1990s led to lower-priced alternatives for direct insurance coverage, and the CCR and state warranty ceased because they were considered too expensive and unnecessary by many insurers.<sup>210</sup>

### B. *Post-September 11: The Reemergence of an Unlimited Government Guarantee*

The French Gestion de l'Assurance et de la Réassurance des Risques Attentats et Actes de Terrorisme (GAREAT) took effect on January 1, 2002, and was the first terrorism insurance pool implemented after September 11.<sup>211</sup> GAREAT was created following the events of September 11 as a result of reinsurers announcing terrorism exclusions within their

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203. *Id.*

204. *See id.* (discussing a private insurance scheme competitive with Pool Re).

205. *See* PARTNERRE, *supra* note 103, at 16 (discussing terrorist attacks in France in the 1950s and an "increase of political risks" in the 1970s that led to the availability of additional insurance coverage options).

206. *See id.* (noting that in 1982, "a [l]aw was introduced which allowed the [Caisse Centrale de Réassurance] to reinsure terrorism policies").

207. *Id.*

208. *Id.*

209. *Id.*

210. *Id.*

211. *Id.* at 4.

reinsurance treaties, which left direct insurers potentially unable to renew existing commercial policies.<sup>212</sup> GAREAT is a “reinsurance pool covering commercial and industrial risks as from the beginning of 2002 for direct property losses and business interruption arising from acts of terrorism where the sum insured is in excess of €6 million.”<sup>213</sup> The government again stepped in and agreed to act as a reinsurer of last resort through the CCR for acts of terrorism<sup>214</sup> causing damage if annual aggregate losses exceeded €1.75 billion.<sup>215</sup>

Membership in GAREAT’s reinsurance program is not mandatory for French insurance companies.<sup>216</sup> Insured “[r]isks must be located in Metropolitan France, the French Overseas Departments and Territories . . . and Mayotte.”<sup>217</sup> Like the Pool Re amendments that followed the creation of GAREAT,<sup>218</sup> “nuclear, chemical and biological risks” (including “dirty bombs”) are covered under GAREAT.<sup>219</sup> These risks are covered under GAREAT as a result of the French Penal Code’s broad definition and the government’s realization that nuclear, chemical, and biological risks are a major terrorist threat.<sup>220</sup> Unlike TRIA,<sup>221</sup> GAREAT has no liability cap; the CCR’s state-backed guarantee offers unlimited protection.<sup>222</sup>

## X. CONCLUSION

Terrorism appears to be an unfortunate part of our modern day existence as evidenced by the events of September 11, 2001 and the more recent terrorist attack in Madrid on March 11, 2004. This international inquiry highlights the devastating effect that even a single act of terrorism can have on a nation’s economy and insurance industry. In our

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212. AON, *supra* note 111, at 8.

213. *Id.*

214. See PARTNERRE, *supra* note 103, at 19 (defining terrorism). Under France’s broad definition, terrorism is defined as “a concerted violent action, intended to influence the State or public authorities. It excludes secret actions such as malicious acts or sabotage.” *Id.*

215. AON, *supra* note 111, at 8.

216. *Id.*

217. *Id.*

218. See discussion *supra* Part VIII.D.

219. See PARTNERRE, *supra* note 103, at 19-20 (citing this coverage as an attractive characteristic for risk managers because the reinsurance market often excludes these types of risks).

220. *Id.*

221. See discussion *supra* Part IV.C (discussing the limits of TRIA).

222. See AON, *supra* note 111, at 9.

increasingly interconnected world, acts of terrorism perpetrated halfway across the world may have devastating international consequences. Modern terrorist attacks inflict much greater devastation in terms of lives lost, injuries incurred, and monetary damage suffered. However, because terrorism has decreased in frequency, nations may forget too soon the devastation wrought by an act of terrorism and fail to protect their citizens and economies.

The European terrorism insurance pools provide a variety of lessons for the United States. It is important to note that the pools in existence prior to September 11 remained in existence even though terrorism might lie dormant for many years at a time. These countries have realized the importance of preparing for the worst, which enables their economies to sustain the adverse effects of a terrorist attack. Prevention and preparedness may be the greatest defense for the economies of these European countries. Although the Terrorism Risk Insurance Act is scheduled to sunset in December of 2005, we can learn from these European countries the necessity of a long-term terrorism insurance coverage program, one that may only be viable with government involvement. Under these long-term European programs, a commercial market for terrorism coverage has emerged and insurers have been able to insure commercial property owners because of the government-backed reinsurance mechanism designed to prevent against loss. In protecting their nations' economies with a government guarantee to insulate loss, these European countries have realized the importance of making commercial property terrorism insurance available to all.

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