

US terrorism risk – what you need to know

How terrorism is defined. And what is (and isn't) covered in today's market.

The brave new world

Terrorism acts are a peril we are exposed to frequently, and yet they are surprisingly difficult to quantify and can be unwieldy from a risk-management perspective. Terror is a peril where history cannot easily predict the future frequency and severity of events. That doesn't make terrorist acts uninsurable, but it can make them more difficult to insure than some other perils.

That said, global governments have created programs and/or backstops with the express purpose of making terrorism insurable for constituents. It's worth considering the US government's definitions and policies on terrorism, and how insurers' own policies may hold up or fall short in the event of a terrorist act.

Terrorism in the US

Terrorism is considered a man-made peril covered by the private sector and a US government backstop named the Terrorism Risk Insurance Program (TRIP). Congress created TRIP in November 2002 following 9/11, and in January 2015, it renewed TRIP through 2020. (Note: TRIP is also often referred to as TRIA [Terrorism Risk Insurance Act] after the authorizing legislation that created the program.) TRIP has yet to be utilized but here are some of the most important aspects of the program:



Key Figures	Importance
USD 5 million	Per-event insured losses for commercial property and casualty must exceed this threshold in order to be considered for "certification" as an Act of Terrorism by the Secretary of Treasury.
USD 100 million for 2015, increasing yearly by USD 20 million to USD 200 million for 2020, and each year thereafter	Aggregate industry losses from the certified act(s) must exceed this threshold for TRIP-loss payments to be triggered (though certification can still occur).
20% insurer deductible (the primary retention amount)	It's the percentage of the insurer's direct-earned premium from the previous year in TRIP-eligible insurance lines (principally: commercial property, business interruption, workers' compensation, and general liability).
15% quota-share (the insurer co-share amount) for 2015, increasing yearly by 1% to a 20% quota-share for 2020	It's the percentage of the loss retained by TRIP-eligible insurance companies after their deductibles (hence, the government reimburses the insurers for 85% of their eligible losses for 2015, decreasing to 80% by 2020).
USD 27.5 billion for 2015, increasing yearly by USD 2 billion to USD 37.5 billion for 2020; after which time, the amount shall be equal to the annual average of the sum of participating insurer deductibles for the prior three calendar years	The TRIA payout threshold triggers policyholder assessments for mandatory recoupment of federal TRIP payments; the full recoupment period varies from two years for acts committed on or before year-end 2017, to, at most, just over six-and-a-half years for acts committed thereafter.
USD 100 billion	There is a cap on aggregate TRIP payments in a program year (Congress would need to authorize additional payments).

What is a certified act of terror?

The Secretary of Treasury, Attorney General and Homeland Security Secretary together determine what is a "Certified Act of Terrorism." To date, the government has never certified an act of terror, but an event must:

- Be an act of terrorism rather than an act of war. The key distinction is that acts of terror target non-combatants or soldiers and are done by sub-national groups. It should be noted that workers' compensation is the only line of business under TRIA that also includes act of war-related injuries and fatalities.
- Be violent or dangerous to human life, property, or infrastructure.
- Result in damage within the US (if outside the US, there must be damage done to an overseas US air carrier, US flag vessel or US mission).
- Be committed by individuals meant to influence the policy or conduct of the US government.
- Be one where property and casualty insurance losses exceed USD 5 million per the event.

Coverage considerations, the knock-on effects

It is important for insurance companies to have a clear strategy when it comes to terrorism coverage and their use of TRIP. For example, what is the appetite for writing domestic, foreign and nuclear, biological, chemical and radioactive (NBCR) coverage after contemplating how much TRIP coverage there is? This may depend on rate adequacy, the ability to spread the assumed risk geographically, and the amount of exposure in key cities.

There is clear value in addressing terrorism coverage in a company's comprehensive business strategy. At the end of the day, the 20% TRIP deductible and 20% TRIP co-insurance provision (per TRIP in 2020) can be a very meaningful exposure. Is it necessary to buy more traditional reinsurance protection or is it okay to take on the net exposure?

Companies must carefully draft primary-policy language to make sure it is clear and fits well with the coverage they wish to offer, and the backstop provided by TRIP. The potential for gaps in coverage has been significantly reduced since TRIP no longer distinguishes between "foreign" and "domestic" acts. Depending on the perceived attractiveness of the market opportunity, a company may now consider offering more comprehensive coverage in high-risk areas with a lesser risk of unintended net retentions. (It is important to note that while the law does not explicitly address coverage for losses from NBCR attacks, a 2004 letter of guidance from the Department of Treasury concludes that NBCR losses would be covered. NBCR coverage is not always available in the traditional reinsurance market, so this may present a potential meaningful net exposure within the TRIP retention.)

The Secretary of Treasury, Attorney General and Homeland Security Secretary together determine what is a "Certified Act of Terrorism." To date, the government has never certified an act of terror.

Other important considerations when drafting primary-policy language, and assessing net exposure, include:

- TRIP does not differentiate between terrorism-attack modes. If a primary policy covers risk of loss from cyber events (whatever the cause), it may also cover cyber-related terror events. Such a loss would be applicable for recovery under TRIP, assuming all other conditions are met.
- Homeowners policies generally provide for terror coverage and are not addressed by TRIP. All losses in excess of traditional reinsurance are retained net by the company.
- If commercial terror cover is declined in the primary policy, a fire-following terror event is still typically covered and would be recoverable by TRIP. Some states allow for a fire-following exclusion as well.

The market for terrorism

Several vendor models (i.e. RMS, AIR, etc.) are used by the industry, but some companies have created their own proprietary models. Results can vary significantly. Companies need to understand how the various models view their portfolios. It is imperative to question or challenge model assumptions and results when they do not properly reflect underwriting action or mitigation efforts being made. To that end, Swiss Re uses a proprietary model based on market share in target cities.

By law, insurance companies must offer terror coverage to all commercial accounts; the industry take-up rate has remained steady at 60% since 2015.

Swiss Re monitoring

Swiss Re is a member of the TRIP federal advisory committee on terrorism risk. This allows Swiss Re to represent its views and those of clients when it comes to TRIP, and the availability and scope of any government backstop. Swiss Re has a regulatory affairs team in Washington, D.C., which continues to advocate for TRIP as an effective government backstop.

Contact your Swiss Re representative to learn more.