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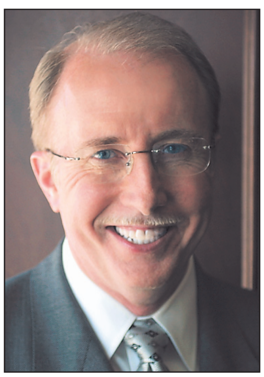
Perspectives

Private, government terror cover is possible

By Ronald R. Robinson

The Terrorism Risk Insurance Act of 2002 is a private financial markets/government insurance program designed specifically to cover only losses from foreign terrorist attacks on American soil, ships, aircraft and international missions. It will expire on Dec. 31. What sort of terrorism risk programs ought to, could—and will—be developed to replace TRIA? Should private financial market products or government/insurer risk transfer partnerships replace TRIA? What scope of terrorism coverage should be available in personal, property and casualty lines?

If these TRIA succession issues are to be resolved by deliberation rather than by default, TRIA will have to be continued for at least two years beyond Dec. 31, so that what follows can be created and implemented in an orderly manner, without gaps in terrorism risk coverage.



Two key issues, though, must now be resolved independent of that question, whatever happens to TRIA. How shall newly emerging and interim private terrorism insurance products be structured, and what role will that process play in the TRIA succession debate?

Before Sept. 11, 2001, all policies in place in all major lines of insurance in the United States included, or were read to include, terrorism risks. But the coverage in these lines did not provide the specificity of coverage for terrorist losses that many analysts now believe is crucial to the continued solvency of private markets. Historically validated specific-peril underwriting principles and their unique standard language provisions could easily be adapted to create stand-alone coverage sections or endorsements amending policies to create a specific-peril terrorism coverage program in each line of insurance. This approach stands the best chance of establishing solvent and easily administered coverage. The resulting product could be the core structure in any successor program to TRIA, be it private or public or a partnership of both.

A specific-peril program for terrorism risks would contractually define and limit the risks transferred from policyholders to insurers and/or to the federal government and, thus, leave no doubt as to the portion of the risk retained by each party. Using this historically proven contract approach, insurance for future terrorist losses could be quantified and prudently issued in order both to continue and expand this coverage in all lines. More importantly, this process can begin now in the private sector as a precursor to and foundation for whatever it is that follows TRIA.

A private market/government partnership successor to TRIA using a specific-peril program approach would consist of two coverage tiers, constructed much like classic tiered large-risk programs. First, the private-sector tier would consist of primary, umbrella and excess policy specific-peril terrorism endorsements or sections in: life, workers compensation, health and accidental loss policies; first-party policies for fire, property destruction and business interruption loss; and third-party liability policies.

Second, a federal government tier would attach above the limits of the private-sector tier and "follow form" to the latter's underlying policies in all lines.

In such a partnership specific-peril program, the actual coverage for both tiers would rely on contract language, not the statutory and political decision approach that defines TRIA. This language would be written specially for each separate policy section or endorsement in each line using specific-peril underwriting principles. Premiums need finance such a specific-peril terrorism program only at the private tier, with U.S. Treasury revenues and surpluses being used to fund the governmental tier. The private insurance market has the most efficient mechanism to collect premium from and then return it to all segments of our society through investments, the payment of claims, awards and defense fees and costs, and the creation of jobs. Traditional private-sector economic forces, bolstered by this premium mechanism, should, in turn, stimulate our economy, increase Treasury revenues and, thus, pay for government-tier losses.

As the governmental tier would become involved in a given claim, the last private insurer directly handling the loss would continue to administer it. The money necessary to pay a loss in excess of the private tier would come from the Treasury, while the private tier would handle the claim and actually pay the loss. Insurance companies have existing, tested and comprehensive claims-handling mechanisms. They are the partner that can better pay and defend claims. Specific-peril program claim decisions would be contractually based and not, as under TRIA, be driven by statutory and political paradigms. The culture of the private financial markets, driven as it is by contract, would be unlikely to engage in the politically based claim decisions that are mandated in TRIA.

If terrorism insurance coverage is to continue, let alone expand, the TRIA succession debate must begin in earnest now with an extended TRIA in place.

A specific-peril terrorism insurance program would require neither dramatic nor extensive changes to existing infrastructures or laws. It could be built "from the ground up" in the private sector, rather than being imposed by government "from the top down." TRIA could provide temporary stability and security while private insurance markets made the necessary specific-peril program underwriting choices, created policy provisions and fixed policy limits, tier attachment points and premium rates. TRIA's public coverage approach could, at the same time, be revised along these lines, a new government-tier approach created or the role of Treasury in this coverage ended. If insurance for this risk is to continue, let alone expand, the TRIA succession debate must begin in earnest now, with an extended TRIA in place to provide a realistic window of time within which to do this critical job.

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