CAPTIVES MEETING A NEED IN
TERRORISM RISK

By Karrie Hyatt

The U.S. Treasury Department is currently collecting data for its second report on the effectiveness of the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA). In its first report, issued in June 2016, the Department found that the Terrorism Risk Insurance Program fulfills an important need in the insurance marketplace—making terrorism risk coverage more affordable and more readily available than it would be without the Act.

Since Congress passed the Terrorism Risk Insurance Act of 2002, captive insurance companies have played an important role in providing terrorism risk insurance. Insuring terrorism risk through a captive offers the same benefits of insuring any risk through a captive—including flexibility of coverage, control of risk, keeping underwriting profits, and access to reinsurance. However, captives can offer even more benefits and wider coverage when it comes to terrorism risk insurance, including access to the federal Terrorism Risk Insurance Program.

Terrorism Insurance Act

The Terrorism Risk Insurance Program (TRIP) is essentially stop loss insurance provided by the Federal government in the event of a terrorist event. Prior to September 11, 2001, terrorism coverage was included in standard property and casualty insurance policies. The terrorist attacks on September 11th resulted in approximately $43 billion in property and casualty insurance losses, more than half of it paid by reinsurers. As a result, many insurers began excluding terrorism risk coverage from their regular policies.

In 2002, seeing that the loss of coverage could have a heavy impact on businesses, Congress enabled the Terrorism Risk Insurance Act of 2002 (TRIA) which requires insurers to make available terrorism risk on certain lines of commercial property and casualty insurance. Because the exposure can be significant, in the event of a terrorist attack a certain amount of losses must be met before TRIP will be triggered to reimburse insurance companies. The program is administered by the Department of the Treasury and eligible events must be declared an act of terrorism by the Secretary of the Treasury and can only be declared so if insured losses surpass $5 million. In addition, once an event is declared a terrorist attack, TRIP reimbursement will only be triggered if aggregate insured losses exceed $200 million.

The Act has been reauthorized three times—in 2005, 2007 and 2015. The most recent reauthorization (Terrorism Risk Insurance Program Reauthorization Act of 2015) saw the increase in aggregate insured losses from $100 million to $200 million and now requires the Treasury to collect and analyze data in regard to the program and provide an annual report on its effectiveness.

Last year, the Treasury released its first report. The Department found "that [TRIP] remains an important mechanism in ensuring that terrorism risk insurance remains available and generally affordable in the United States. Viewed on a national basis, the coverage being made available is comprehensive and would likely not be possible in the absence of [TRIP]."

What Captives Can Offer

While traditional insurers are required by TRIA to provide certain lines of terrorism coverage, captive insurers are not. However, they can participate in the Program by choice. This means that the captive owner/insureds are responsible for choosing whether or not to access TRIP. The Treasury's report found that captives purchase standalone terrorism coverage at a higher rate than other reporting insurers, and that they purchased a substantial amount of reinsurance to cover an act of terrorism certified under TRIA.

When the Department of the Treasury was considering barring captives from accessing TRIP in 2016, SIIA argued that terrorism risk insurance is "not one size fits all" and that every company can't rely on traditional insurers to offer the coverage all companies need.

That's where captives and other alternative risk transfer insurers can help. Captives are still able to tap into the TRIP program, but they have the flexibility to offer a wider range of coverage than traditional insurers. Additionally, captives can offer policies that fill in gaps in coverage not available through insurance companies and captives will insure where traditional insurers may not be willing. Even with policies that are finely tailored to its parent company's needs, captive policies are likely to be competitively priced as well.

Emerging Terrorism Risk

While TRIA requires insurance companies to make certain terrorism risk coverage available to policyholders, there are ways that traditional insurers can mitigate their exposure. Declining to write certain risks and not offering coverage for certain forms of losses are two ways that insurers alleviate risk exposure.

According to the Treasury Department's report, "Insurers can even decline to write a particular line of insurance entirely if that line presents too great a risk of loss on account of terrorism."

One such risk is Nuclear, Biological, Chemical, and Radiological (NBCR). While covered by TRIP, insurance companies are not required to offer it. The nature of this type of terrorist attack is low risk but high payout and it's nearly impossible to predict the extent of outcome for this type of attack. For example, large metropolitan hospitals often have NBCR waste stored on the premises. In the event of an explosive device detonating, these materials can be scattered over a large area, contaminating the hospital premises and neighboring areas. Weather conditions can spread the damage even further.

Hospitals will not likely be able to purchase NBCR risk as part of a regular policy, but they can purchase it from a traditional insurer as a standalone policy. But even that may be hard to get if the insurer is already insuring a concentration of other businesses in the same geographic region. The flexibility that captives offer can guarantee companies get the NBCR risk coverage that they need.

Another is risk that traditional insurers may shy away from is cyber terrorism risk. While more and more companies are purchasing cyber liability coverage, most of it falls under professional liability coverage, such as what would be needed to cover the hacking of a business's customer information. Cyber terrorism risk is a different animal altogether—and, at this time, what form it will take and the extent it will reach can only be guessed.

A cyber terrorist attack could come in the form of tampering with power grids or infiltrating operational technology, such as a nuclear facility or bio-chemical plant, and causing an explosion. Actuaries are hard pressed to come up with probability scenarios for this type of risk and insurers are wary of offering coverage for an act

that seems so ephemeral today. Again, captives have the capacity to create policies that address these risks in a way that traditional insurers do not.

Another type of terrorism risk that captives have the capacity to insure are contingency losses— contingent interruption of operations and contingent time-element loss. Terrorism risk in the early 2000s was primarily associated with property damage, but as the definition of what constitutes a terrorist attack expands, more interest is being paid to the losses that surround an attack, such as business interruption.

Contingent interruption of operations risk is similar to business interruption risk, but goes farther to include business losses due to cancelled reservations, indefinite business closure, or other disruptions that could reduce business income. Contingent time-element loss covers business disruption in a third-party supplier or a customer that affects the insured business. Again, these types of risk are difficult to anticipate and the flexibility of policies that captives employ gives them an edge over traditional insurers with cookie cutter policies.

The Secretary of the Treasury has yet to declare any event an act of terrorism and the TRIP has never been triggered, but the day may soon come when it could happen. As the threat of terrorism becomes less straightforward and more sophisticated, captive insurance companies are taking the lead in creating more dynamic terrorism risk insurance coverage. ■

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