THE IMPACT OF SEPTEMBER 11 ON TERRORISM INSURANCE: COMPARING SENATE BILL 2600, HOUSE OF REPRESENTATIVES BILL 3210, AND THE UNITED KINGDOM'S POOL RE.

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I. INTRODUCTION

“If insurance is a small world that reflects the purposes of the larger world outside it,” if the events of September 11 have dealt a devastating blow to both worlds. In the larger world, even as images of the now infamous terrorist attacks at the World Trade Center (hereinafter WTC) linger in our minds, the rubble is being cleared away, and life has slowly returned to a familiar normalcy. However, in the smaller world of insurance, there is an ongoing struggle between factions, each striving to find the best solution to a problem whose consequences may be as dire as the events that created the controversy.

The impact of September 11 is without peer. The terrorist attacks that on that fateful day dealt the world’s insurance community its hardest blow ever. The shock that such an event could happen was only made worse by the

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realization that the insurance industry's estimates for such an event fell so short. The previous largest worldwide-insured loss was from Hurricane Andrew in 1992. Damages in Florida resulting from the natural disaster are now estimated to have caused $20 billion in insured losses. Estimates of losses in the WTC attacks by the insurance industry ranges between $30 and $60 billion. The National Association of Independent Insurers (hereinafter NAII) spokesperson said, “[L]osses from the attacks are estimated at $50 billion.” One independent financial-counseling firm estimated that on a combined basis for property, casualty, life, and health insurance, the WTC property losses might reach $58 billion. Although no one yet knows the total losses from September 11, if the losses reach $60 billion the attacks will have caused insured losses three times greater than any previous event.

Prior to the attacks on the WTC, the United States insurance industry treated terrorism as little more than a footnote, while other countries, such as Great Britain, have repeatedly been forced to deal with the issue. Repeated bombings and terrorist attacks by the Irish Republican Armies (hereinafter IRA) resulted in British insurance agencies re-evaluating their insurance policies. While many United States insurers will not use their war exclusions (discussed below) to avoid paying for September 11 losses, many are looking for ways to avert payment on future losses from terrorist attacks.

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2. Dr. Gordon Woo, Quantifying Insurance Terrorism Risk, 2 (prepared for the National Bureau of Economic Research meeting, Cambridge, Massachusetts, Feb. 1, 2002).
3. TILLINGHAST-TOWERS PERRIN, IMPLICATIONS FOR THE INSURANCE INDUSTRY 9 (2001). (Tillinghast-Towers Perrin is one of the world’s largest global management consulting firms, assisting organizations in managing people, performance and risk; HR consultants help organizations manage their investment in people to achieve measurable performance improvements, focusing on human resource strategy and service delivery, benefit and compensation design and implementation (including retirement, health and welfare and executive compensation), employee and organizational communication, HR technology and outsourced HR administration, providing actuarial and management consulting to financial services companies worldwide; and providing reinsurance intermediary services and consulting expertise that focus on the creative blending of traditional and nontraditional risk-transfer vehicles.).
5. Martha Neil, Terrorism Insurance Bailouts Stall In Congress, 2002 ABA J. E-REPORT 3, 2. (Joseph Annotti is the spokesman for the NAII, a Chicago based Association of Insurers.).
6. TILLINGHAST-TOWERS PERRIN, supra note 3, at 4. (These estimates were based on information available approximately one week following the event.).
7. TILLINGHAST-TOWERS PERRIN, supra note 4.
The insurance industry, which incurred billions in losses, may not be able to afford another enormous payout without aid. Even with federal help, another terrorist attack would be a tremendous blow to the insurance industry. The idea that total losses from the WTC attacks will not be known for months, if not years, and the uncertainty of future attacks, have increased certain fears; can reinsurers cover losses that insurance companies are now struggling to meet, and if not, then should the federal government get involved? "While new security measures and the war against terrorism will hopefully diminish the risk, it is nearly impossible to quantify the probabilities of what might happen over the next few months or years."

The United States insurance industry must choose a course that allows insurance rates to remain stable, while ensuring that insurers can handle the payouts that will follow another terrorist attack. Either insurers will have to honor terrorism insurance claims or the Federal Government will have to get involved.

II. THE INSURANCE INDUSTRY PRE-SEPTEMBER 11

Currently, there is no Federal insurance system. All fifty states have their own rules, and the National Association of Insurance Commissioners guides state-by-state coverage. Since September 11, there have been deep concerns regarding the insurance industry's ability to provide coverage for future terrorist attacks. Without aid, many primary insurance companies will

11. Id.
12. Stephen P. Lowe, A Federal Role for Terrorism Risk The Last Word, TILLINGHAST-TOWERS PERRIN 1 (2001). (While new security measures and the war against terrorism will hopefully diminish the risk, it is nearly impossible to quantify the probabilities of what might happen over the next few months or years.).
13. As of June 2002, proposals are being considered by Congress to create Federal Reinsurance as a backstop for future terrorist attacks. As of August 5, 2002, neither Chamber has passed the others proposal.
15. The NAIC works with the states to create uniformity between insurance providers.
pull terrorism coverage, as will the reinsurance companies. Speaking on the effects of going without terrorism insurance, President George W. Bush stated that, "If people can’t buy insurance on a ... project, they’re not going to build the project. And if they don’t build the project, somebody’s not working."17 While this may be a simplification, it is accurate. To get insurance, businesses and individuals will have to pay high premiums, or go ahead without insurance and pray that nothing bad happens. Neither option is favorable, and both put the buyer at a disadvantage.

Insurance "represents the delicate balance between the uncertainty and the predictability of future events associated with unfavorable consequences."18 Basically, "insurance is the sharing of risk by many parties so as not to create a financial hardship should loss affect one of the parties."19 Insurance creates a pool that allows many participants to share the risk of an event with other purchasers. Each purchaser receives protection against substantial but uncertain losses in exchange for making regular payments called premiums. The system is based upon the “Law of Large Numbers” and uses statistical models based on data gathered from past experiences.20 By gathering this information, the insurance industry can forecast future losses and create resources to pay claims.


The ‘Law of Large Numbers’ is the statistical proposition that the more opportunities exist for an event to occur, the closer the actual relationship of occurrences to opportunities will be to the true probability. Lewis C. Workman, The Mathematical Foundations of Life Insurance 121 (1982). Once the true probability is estimated by observing a large sample of events, it must then be applied to a large number of exposures before the actual occurrences will approximate the true probability. Emmett J. Vaughan & Therese M. Vaughan, Fundamentals of Risk and Insurance 25 (7th ed. 1996). Extremely catastrophic events are generally considered to be uninsurable in part because by nature they fail to conform to models based on the Law of Large Numbers. Riegel et al., supra note 10, at 20-21. Past experience with events of such great magnitude is usually too sparse to accurately predict how often a similar event can be expected to occur. Id. Further, where a particular loss is grossly disproportionate to other losses that can be anticipated to occur within the pool of policyholders, the catastrophic loss invalidates the calculation of rates and has the potential to create insolvency for the insurer. Id."
While primary insurers deal with businesses and individuals, reinsurers deal with primary insurers. Reinsurance companies are the "wholesalers in risk," dealing only with other insurance companies. As a result, they are not very visible, but they are vital to the industry, since without them, primary insurers would not be able to diversify their risks properly. They provide insurance between the primary insurance company and another party, usually when the primary insurer assumes a policy too large to handle alone.

"A ‘reinsurance’ contract is an agreement where one insurance company, the reinsurer, agrees to indemnify another insurance company, the reinsured, either in whole or in part against loss or liability the latter may incur under a separate and original contract of insurance with a third party, the original insured." Reinsurers, like primary insurers, look to the past to set their rates. Resulting losses from the September 11 WTC attack, the 1993 WTC attack, and the destruction of the Alfred J. Murrah Federal Building in Oklahoma City, have proven that the insurance industry is unable accurately measure the costs of future attacks. These past attacks gave little predictability in what manner future attacks would take, and gave even less insight into losses in life, property, and business.

The problem with what happened on September 11 is that it presented a risk that no one could conceive would happen. When the buildings were built, loss scenarios did contemplate the impact of one Boeing 707 (the largest commercial aircraft at the time), however the idea of two, fully fueled 767s hitting both towers was unimaginable.

21. Wasow, supra note 8, at 3.

22. Id. at 1.

23. Id.

24. Id.


27. Honorable Paul H. O’Neill, Testimony Before the Committee on Banking, Housing and Urban Affairs, United States Senate (Oct. 24, 2001).


Certain situations known as clash events result in a breakdown of the reinsurance system. "In a clash event, an occurrence, often unanticipated or unpredictable but of catastrophic proportions, concentrates significant losses across multiple lines of insurance simultaneously."\textsuperscript{30} The WTC disaster created massive insurance claims in aviation, property, liability, life, workers' compensation, and business interruption.\textsuperscript{31} When the primary insurers turned to the reinsurance companies, many found them to be spread too thin to adequately cover the tremendous losses.

If the WTC attacks are the worst known terrorist attack in the history of the insurance industry,\textsuperscript{32} then the potential that reinsurers and primary insurers may not be able to cover their policy holder's claims may be the insurance industry's greatest failure. To combat this real possibility, many in the industry are looking to avoid this situation when reinsurance policies come up for renewal. When reinsurance companies who provide insurance to primary insurers began to renew their contracts in January 2002 (reinsurance policies are annual, and renegotiated every year), many reinsurers refused to provide coverage for losses relating to terrorist acts.\textsuperscript{33}

III. EXCLUSIONS – WAR V. TERRORISM

Following the terrorist attacks, primary insurers "assured their policy holders that they would not invoke the 'war' exclusion to deny coverage."\textsuperscript{34} On its face, this appeared to be a magnanimous gesture, but in actuality, these insurance carriers had no alternative. As presently written, the standard war exclusion does not explicitly extend to acts of terrorism."\textsuperscript{35} Congress also made its position crystal clear when it stated that any attempts by insurance agencies to side-step their contractual obligations would "not only be unsupportable, it would be unpatriotic."\textsuperscript{36}

\textsuperscript{30} Kendall, \textit{supra} note 18, at 580.
\textsuperscript{31} TILLINGHAST-TOWERS PERRIN, \textit{supra} note 3, at 4.
\textsuperscript{32} \textit{Id.} at 2.
\textsuperscript{34} Rizzo, \textit{supra} note 10, at 10.
\textsuperscript{35} 'Act of War' Exclusion Doesn't Apply to Attacks, Insurers Say, L.A. TIMES, (Sept. 17, 2001), at Business, 3.
\textsuperscript{36} Letter from the House Committee on Financial Services to the National Association of Insurance Commissioners I (Sept. 17, 2001). ("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 insurance industry.").
This has left many primary carriers in an unpleasant situation. Primary insurers were left with a very simple, yet unpleasant decision; cover the risk and hope that the losses do not exceed the ability to pay.\textsuperscript{37} However, this is an almost impossible task, considering that the market is based on predicable losses for a certain event and there are no possible ways to accurately predict damages from acts of terrorism.\textsuperscript{38} Some primary insurers can try to limit or exclude terrorism coverage completely. Many primary insurers who cannot find reinsurance companies to cover acts of terrorism are doing just that.\textsuperscript{39}

A major issue that reinsures and primary insurers face is ambiguous policy language. The distance between "war" and "terrorism", may not seem great, but it could be the difference in billions of dollars to insurance providers. Most insurance policies exclude losses from declared war or losses from invasion by a sovereign power, but lack language that would address coverage in the face of a terrorist attack.\textsuperscript{40}

"Exclusions for losses arising from acts of terrorism, although rare, are not completely unknown in existing United States policies."\textsuperscript{41} The United States Court of Appeals for the Second Circuit noted that war risk insurers already had circulated various versions of exclusions for terrorist activities, stating,

Any of these ... clauses, if employed by the appellant all risk insurers might well have excluded the present loss... When the all risk insurers failed to exclude political acts in words descriptive of today's world events, they acted at their own peril. The clear implication of this is that it is possible to exclude coverage for damages and injuries caused by terrorist acts with the proper policy language.\textsuperscript{42}

President Bush said, "The deliberate and deadly attacks, which were carried out yesterday against our country, were more than acts of terror. They were acts of war."\textsuperscript{43} Yet, the tragic events of September 11 are not covered under existing "war" insurance exclusions. Therefore, insurance agencies cannot claim the September 11 attacks were those of "war." A terrorist group, other than a de facto government or entity acting on behalf of a government,

\textsuperscript{37} Marjorie Segale, The Event That Changed The World of Insurance, TERRORISM REPORT, IBA WEST, VOL. 1, NO. 1, 2, (2002).
\textsuperscript{38} Rizzo, supra note 10, at 12.
\textsuperscript{39} Segale, supra note 37, at 2.
\textsuperscript{40} Rizzo, supra note 10, at 12.
\textsuperscript{41} Sherman-Williams Co. v. Ins. Co. of the State of Pa., 863 F. Supp. 542 (N.D. Ohio 1994) ("[T]errorist" exclusion was in standard form policy at issue and coverage for losses due to terrorist acts was restored by endorsement, for which insured paid additional premium.").
\textsuperscript{43} Quoted in Kendall, supra note 18, at 569.
cannot commit an act of war. For a terrorism exclusions to apply, the contractual language should stipulate that a terrorist act may, but need not, be committed by or on behalf of a group that comprises a de facto government or a recognized government. Without this clause, small factions will not apply to the terms of the war exclusion.

"The actions of a 'tiny non-governmental entity' fighting the United States do not constitute 'war' between the United States and that entity." If the insurance industry is going to exclude terrorism coverage, insurers should make it clear that the size of a terrorist organization is not relevant to the determination as to whether or not its act is excluded. "Words describing violent events commonly used in war-risk exclusions are construed as having 'dimensions besides the level of violence,' which may include requirements that multiple actors be involved." Hence, while the terrorist acts of the Al Qaeda organization may demand an answer, they were not acts borne from a recognized war.

In the days following September 11, many observed that this attack was so well planned, so meticulously masterminded, that it had to have been the work of an extremely well funded and organized terrorist network. Osama bin Laden’s terrorist network, Al Qaeda, is a non-governmental entity, and a self-proclaimed terrorism organization. A "war," whether declared or undeclared, can exist only where sovereign or quasi-sovereign entities engage in hostilities. Terrorism exclusions should clearly specify that terrorist acts may be committed on behalf of or sponsored by any sovereign or quasi-sovereign entity. While some reports claim that bin Laden was a Taliban Defense Minister, the use of extremists, rather than soldiers, to hijack and crash airplanes into the WTC barely constitutes a foreign states involvement. Therefore, contrary to President Bush's statements, the horrible attacks on the WTC cannot be considered acts of "war".

Acts of terrorism are not included in standard insurance policies, where similar acts of destruction are expressly excluded from coverage in acts of war,
hence the "war exclusion." "Few insurance policies underwritten for domestic risks contained exclusionary language for acts of terrorism. All, however, excluded coverage for damages to persons or property that were the result of an act of war."54 War, is a "hostile contention by means of armed forces, carried on between nations, states or rulers, or between citizens in the same nation or state."55

Terrorism, however, 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."56 Should the United States be subjected to future acts of terrorism as a result of its military activities, insurance carriers may be able to invoke the war exclusion and terrorism exclusion, or the insurance agency may select to combine war and terrorism into one exclusion policy, to preclude coverage for resulting personal injury or property damage losses.57

IV. THE PROBLEM DEFINING "OCCURRENCE"

In the aftermath of the WTC attacks, many questions have been raised regarding the ability of insurance companies to compensate policy holders for losses caused by the terrorist's acts. The most costly risk facing the insurance industry is the difference between one occurrence and multiple occurrences. One attack may result in fifty billion dollars in insured losses. But if the events of September 11 were defined as two attacks, the amount that can be collected under the WTC policy would double.58 The problem stems from an interpretation of the term "occurrence."

"Insurers and reinsurers are familiar with disputes over situations in which a determination as to the number of occurrences can have major financial significance."59 Determining the number of occurrences has drastic impacts on

54. Rizzo, supra note 10, at 12.
56. 28 C.F.R. § 0.85 (2001), cited in Rizzo, supra note 10, at 12.
57. Id.
59. John W. Stamper, Looking at the Events of September 11: Some Effects and Implications, While the Impact on Insurers is Large and Apparent, there are Many Other Possibilities, Even Probabilities, of Contentions and Litigation, 69 DEF. COUNS. J. 152, 159 (2002). (Environmental policies are familiar insurance claims.).
the ability of policyholders to collect, and affects both primary insurers and reinsurers. The question that will beg this analysis is: was the occurrence multiple hijacked aircrafts that crashed into multiple buildings, or was the occurrence a single and unified terrorist plot that destroyed the three buildings? “If the cause or occurrence is deemed the terrorist plot then the case in the federal courts may call the destroyed buildings one occurrence. If each plain crash is a separate incident then the incidents may be ruled separate occurrences.”

“Given their close coordination, were all four attacks one occurrence? Were they all separate? Were the attacks on the World Trade Center one occurrence regardless of the others?” If the decision is one loss, the insurers will be liable for the occurrence limit in the policy.” Larry A. Silverstein, the WTC leaseholder, says each airplane crash involved in the disaster constitutes a separate “occurrence.” If this were true, then a finding of two “occurrences” would double the $3.6 billion Silverstein would collect to $7.2 billion.

Several insurance companies that cover other property damaged in the WTC attacks believe “that because the attacks were coordinated, they qualify as a single occurrence.” The New York Court of Appeals answered the question of how to determining the “number of occurrences” of an event. The

60. Id.
61. Branigan, supra note 19, at 532.
62. Stamper, supra note 59, at 152.
63. Branigan, supra note 19, at 532.
64. Perricone, supra note 42, at 27.
65. Id.
66. Id.
67. Id. at 27-8.

On October 16, 2001, the court firmly rejected a ceding company's attempt in two separate cases to characterize underlying environmental claims arising from numerous different sites across the country into one "disaster and/or casualty" per insured. The two cases were resolved by the court in a single opinion, Travelers Casualty & Surety Co. v. Certain Underwriters of Lloyd's of London, cases 123 and 124. The cases stemmed from pollution-related claims against two separate industrial insureds, E.I. du Pont de Nemours & Co. and Koppers Company (n/k/a Beazer East, Inc.). Both insureds submitted insurance claims to Travelers after incurring substantial expenses associated with different sites across the country, where they had been held responsible for the release of hazardous substances into the environment. Travelers ultimately settled with each company for substantial sums. Travelers had reinsurance treaties with Lloyd's that obligated Travelers reinsurers to cover "each and every loss" exceeding a retention level. Travelers argued in both cases that it could aggregate the losses from multiple environmentally contaminated sites owned by the respective insureds as one "disaster and/or casualty" per insured under the wording of the reinsurance contracts at issue. Under the facts of each case, that position, if upheld, would mean that Travelers could surmount the retention limits in the treaties and thus be entitled to a recovery. Travelers based its argument primarily on a 1996 decision by the English House of Lords, Axa
court looked at the acts necessitating coverage, and the policy language, which said, "... all loss[es] resulting from a series of accidents, occurrences and/or causative incidents having a common origin and/or being traceable to the same act, omission, error and/or mistake shall be considered as having resulted from a single accident, occurrence and/or causative event."68 The court said "the phrase 'series of' created a requirement of a temporal and spatial relationship among any accidents to be aggregated under the wording. ... Thus, [an] attempt to treat the ... claims ... as one 'disaster and/or casualty' for ... allocating related costs ... was barred by the policy language."69

In October of 2001, SR International Business Insurance (Swiss Re), filed a declaratory judgment action in the Southern District of New York in order to resolve the question: How many occurrences took place on September 11, 2001?70 Swiss Re provided the World Trade Center policyholders coverage in excess of a $10 million. Swiss Re asserts that the policy drafted by the WTC leaseholders' insurance broker, Willis Ltd. States that the term "occurrence," is defined as: "All losses or damages that are attributable directly or indirectly to one cause or one series of similar causes. All such losses will be added together ... will be treated as one occurrence irrespective of the period of time

Reinsurance v. Field, 5 Re LR 184.
69. Pernicone, supra note 42, at 28.

In that action, 'Plaintiff Swiss Re' seeks, inter alia, declaratory relief regarding the insurance entitlements of Defendants. In response to the SR Int'l Complaint, the Silverstein Properties asserted counterclaims against numerous other insurers seeking monetary and declaratory relief in the SR Int'l action. (World Trade Center Properties LLC, et al. Am. Answer & Countercls., filed on February 6, 2002). The extent of the liability of the insurance carriers may ultimately depend upon resolution of the question: Which of the two following statements best describes what caused the destruction of the World Trade Center on September 11, 2001) In a single coordinated attack, terrorists flew hijacked planes into the twin towers of the World Trade Center.2) At 8:46 A.M. on the morning of September 11th, a hijacked airliner crashed into the North Tower of the World Trade Center, and 16 minutes later a second hijacked plane struck the South Tower. Since most property damage insurance is written on a 'per occurrence' basis—the maximum insured amount will be paid for each covered occurrence—the Court would normally expect to find the answer to the question whether the events of September 11th constituted one or two "occurrences" by looking at how the parties to the insurance contract defined that term in the policy they negotiated. In the case of the World Trade Center, however, with minor exceptions, there were no insurance policies in place on September 11th, although each of the insurers had signed binders setting forth in summary form their agreement to provide property damage coverage. Some of these binders expressly stated that the precise language was "to be agreed upon."
or the area over which such losses occur.”71 The WTC policyholders claim, “that Swiss Re agreed to a policy form underwritten by The Travelers Indemnity Company and the definition of occurrence would be scrutinized under New York law.”72 Under New York law, an “occurrence” is defined as an “event of an unfortunate character that takes place without one's foresight or expectation.”73 The Second Circuit has interpreted this to mean that “although a single 'occurrence' may give rise to multiple claims ... courts should look to the event for which the insured is held liable, not some point further back in the causal chain.”74

Many courts have created two rules for determining how to treat multiple instances of damage stemming from more than one occurrence. “The ... most broadly accepted rule is the so-called 'cause' test ... wherein all losses arising from the same 'cause' are treated as one occurrence.”75 The effect test, an earlier but now largely discredited approach, looked to the “effect of causes in determining whether there were multiple 'occurrences.' While many courts have adopted the cause approach, in practice, however, 'cause' may have many different meanings.”76 However the courts decide to fall on this matter may likely be the difference between insurers covering their policies or falling short.

V. OTHER OPTIONS: GREAT BRITAIN’S POOL RE

“A basic principle of insurance is the reduction of overall risk by pooling or spreading individual, independent risks.”77 An insurers’ inability to accurately estimate potential losses can be detrimental, to say the least. Insurers gauge the risk associated with an activity, and then assign an amount that they will cover (reimburse) on the chance that the event will occur. The attacks on the WTC shed light on the major problem the insurance agency is now facing:

71. Swiss Re Complaint ¶ 31.
72. WTC Leaseholders' Answer and Counterclaim ¶ 75, cited in Rizzo, supra note 10, at 15. (“New York subscribes to the "unfortunate event" test to determine the number of 'occurrences' that have taken place.”).
76. Id. at 172-73. (“For the most part, ...where two losses occur close to each other in time and space as the result of a continuous physical cause, most courts have ruled that they should be treated as arising out of the same occurrence.”).
77. Lowe, supra note 12, at 1. (“But this principle can break down if a single event affects many insureds simultaneously. Geographic concentration or concentration of coverage within an industry (e.g., asbestos manufacturers) creates the potential for contagion.”).
either no one predicted how much damage could be caused, or at the very least, no one accurately predicted the possible scope of damage.

If the private insurance industry cannot underwrite the new risk of terrorism, then a strong rationale exists for a federal role. In the United States, such precedents include the federal flood insurance program and federal riot reinsurance. A more recent example is Pool Re, the U.K. reinsurance program covering terrorist acts. 78

A. The Evolution of Britain’s Pool Re

As in the United States, British losses stemming from acts of terrorism were covered under standard insurance policies. Like the United States, Great Britain’s insurance industry assumed that insured losses from acts of terrorism would be minimal. 79 However, the United Kingdom suffered several terrorist attacks, which culminated in the 1992 bombing of St. Mary Axe, London, where the Irish Republican Army (IRA) caused damages in excess of £350 million in commercial property damages. 80 After this, the British “realized that the unlimited coverage of claims due to terrorism might turn out to be quite expensive." 81

After the St. Mary Axe attack, the insurance and reinsurance industry recognized that they were not able to estimate an accurate determination of damages resulting from further terrorist attacks. 82 Without having the ability to cover losses, or to come close to predicting damages, reinsurers canceled terrorism coverage, and the primary insurance companies followed. “The situation soon became highly political, and enormous pressure was put on both the insurance market and the British government to find some solution to the problem.” 83

The Association of Insurance and Risk Managers in Industry and Commerce (AIRMIC), the risk management community, the U.K. broker community, the British Insurance and Investment Brokers Association (BIIBA), and the Association of British Insurers gathered to answer the dilemma they now faced: how to insure an uninsurable act? Risks that are considered

78. Id.
80. Fleming, supra note 9, at 2.
81. von Ungern-Sternberg, supra note 79, at 7.
82. Fleming, supra note 9, at 2.
83. Id. (Many policies, both in the United Kingdom and the United States renew on or by the first day of the new year. “Since the time scale was so short for those who had renewals on January 1, 1993, there was a horrified outcry from the Association of Insurance and Risk Managers in Industry and Commerce and the risk management community.

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uninsurable have the following characteristics: there are no "objective probabilities that can be used to calculate premium levels; even individual claims can cost large absolute amounts; and geographically the claims are concentrated on a few regions." Ultimately a scheme was devised that was hoped "would maximize the traditional insurance market capacity while requiring government backing." This scheme became Pool Re.

Pool Re is "a government-backed insurance facility in which the Department of Trade acts as a reinsurer of last resort to the insurance market." "Pool Re’s reinsurance contract provides coverage only against acts of terrorism as defined in the Reinsurance (Acts of Terrorism) Act [of] 1993." Pool Re, which was created by "an amalgam of local British Insurers, Lloyd’s syndicates, overseas insurers and captives," is a "mutual insurance company, established and regulated in the same manner as any normal insurance company." Each company that agrees to take part in Pool Re agrees not to provide terrorism coverage themselves; thereby removing competition from other privately backed insurance companies.

"Pool Re is unique to the commercial property insurance market. Pool Re does not provide reinsurance for the homes, personal property or cars of private individuals, or ... reinsurance for terrorist losses on other policies." The pool is reinsured by the British government, meaning that insurers' liability is capped, giving them a ten percent profit or loss-making potential. If the scheme runs badly then everyone who has put premium into the system is obligated to fund another ten percent of premium before the government reinsurance applies.

"The primary insurer is responsible for the first £100,000 (about $150,000) under each section of the policy (building, contents, business interruption, etc.),

84. von Ungern-Sternberg, supra note 79, at 8. ("The St. Mary Axe bombing is a good illustration of how high the claims for one individual event can be. As regards the geographic distribution, it was assumed the IRA would concentrate its ‘efforts’ on the City and perhaps the business centers of other large towns.").
85. Fleming, supra note 9, at 2.
86. Id. at 3.
88. Fleming, supra note 9, at 3.
89. TILLINGHAST-TOWERS PERRIN, supra note 87, at 1.
90. Fleming, supra note 9, at 3.
91. TILLINGHAST-TOWERS PERRIN, supra note 87, at 2. (Such as liability, aviation, workers' compensation and accidental death.).
92. Fleming, supra note 9, at 3.
with Pool Re covering the excess up to the limits of primary coverage.\textsuperscript{93} Any insurer in Great Britain offering commercial property insurance can be a Pool Re member, but is not obliged to join.\textsuperscript{94} Insurers who want to refrain from joining Pool Re, but want to continue offering terrorism insurance, "may offer cover[age] without protection against terrorism, may try to find terrorism reinsurance cover[age] in the private market, or may operate without reinsurance protection."\textsuperscript{95} Insurers who want join Pool Re enter into a membership agreement, essentially purchasing reinsurance from the Pool Re.\textsuperscript{96} Once a member, primary insurers must exclude acts of terrorism in their standard commercial property policies, charge separate premiums for terrorism coverage, and yield 100 percent of the premium charged for Pool Re.\textsuperscript{97}

"According to its annual returns to the Financial Services Authority, at the end of December 2000, the accumulated surplus amounted to £665 million."\textsuperscript{98} Pool Re pays its claims by accumulated underwriting profits. If there are no profits, Pool Re can "call for an assessment on its members of up to 10 percent of their current-year ceded premiums. If this is still insufficient, then Pool Re may draw on any investment income it has accumulated to pay claims."\textsuperscript{99} If there are outstanding claims that cannot be covered by Pool Re, the government will act as a last resort measure, to which there is no limit.\textsuperscript{100} However, if the

\begin{itemize}
\item \textsuperscript{93} TILLINGHAST-TOWERS PERRIN, supra note 87, at 2.
\item The standard commercial property policy specifically excludes coverage for such defined acts of terrorism above the deductible and then restores cover[age] for them via a standard endorsement. The insured can purchase coverage under this endorsement for an earmarked additional premium. In effect, Pool Re provides an automatic facultative excess of loss cover with retention of £100,000 per coverage section. On the excess, Pool Re provides 100 percent quota share coverage.
\item \textsuperscript{94} von Ungern-Sternberg, supra note 79, at 9.
\item \textsuperscript{95} \textit{Id.}
\item \textsuperscript{96} \textit{Id.} at 3.
\item \textsuperscript{97} \textit{Id.} at 1.
\item Pool Re sets its premium rates using nor-mal commercial considerations, and uses risk factors of its own choosing — including the location of the insured property. Discounts are available if the insured engages in prescribed risk management programs. Pool Re reviews its premium rates on a regular basis with the assistance of independent consulting actuaries.
\item \textsuperscript{98} \textit{Id.} at 3.
\item Pool Re’s capital is its own, and is built up entirely from its accumulated profits. According to its annual returns to the Financial Services Authority, at the end of December 2000 the accumulated surplus amounted to £665 million. Pool Re may borrow, and the government guarantees any loans or other lines of credit, but it has never made use of this ability.
\item \textsuperscript{99} TILLINGHAST-TOWERS PERRIN, supra note 87, at 3.
\item \textsuperscript{100} \textit{Id.} at 4.
\end{itemize}
proceeds from member’s premiums exceed £1 billion, then Pool Re must pay a premium to the government.101

The United Kingdom’s Pool Re system was created so that the taxpayer is insulated from immediately being hit with heightened premiums, or worse, not being able to recoup their losses. Pool Re is actually a five-tiered program, where different layers are set in place to meet the losses that policyholders may receive following a terrorist attack.102 “Following an attack, the insurance company pays the first £100,000 per coverage type, with no government reimbursement. Insurers contribute premiums to fully capitalize and maintain a national pool, paying out all claims directly from the pool once the deductible is met.”103

In the instance where the losses exceed the pool, the insurance agency must pay up to an additional ten percent of that year’s premium. If the damages or claims exceed that amount, then the investment income earned by the pool is used to cover the difference.104 If these contingencies fail, then the Government will help to cover the expenses. However, since Pool Re’s inception, the United Kingdom’s government has not been forced to step in to bail out the system.105

Pool Re has curtailed governmental involvement to simply being there to cover Pool Re when its coffers are too low to cover claims.106 The system works by giving the customer insurance while allowing the provider to make some profit. This is accomplished when the primary insurance companies collect premiums from policyholders, of which the insurance company is paid five percent.107 While Pool Re pays coverage from it’s collection of premiums

101. Id.


103. Id.

104. Id.

105. Id.

106. von Ungern-Sternberg, supra note 79, at 10.

Pool Re is clearly a distortion of competition, since the Government provides one of the suppliers with a stop-loss guarantee at zero cost. The Government apparently believed that this was the best way to ensure that businesses could continue having low cost insurance coverage against damages which could potentially be very high.

107. Id. ("If there is a broker between the insurance company and the customer, they get 2.5 percent
and profits from investments, if it's resources exceed £1 billion the Government has the right to recover any funds it may have provided.\footnote{Id. (As of yet, the Government has not needed to intervene, so no monies have been provided or returned.).}

\section*{B. Pool Re's Flaws}

Increased premiums have dogged Pool Re since its inception. "There is no degree of price stability in the arrangements since the British government is determined to ultimately pass costs on to the public. ... If another big loss occurs, there will be yet another public furor over the effectiveness of Pool Re."\footnote{TILLINGHAST-TOWERS PERRIN, supra note 87, at 4.} While the government is borrowing money to pay for existing losses, the debt increases and the burden is placed on the taxpayer.

Because one factor used in determining Pool Re coverage was location, where one owned commercial property could significantly increase policyholder's premiums. The areas found in the highest concentration of terrorist activity originally had the highest rates. "Some property owners experienced a three-fold increase in their total insurance premium. However, as the funds in Pool Re have grown and the terrorist problem has subsided, rates have been reduced."\footnote{Id. at 4.}

The definition of terrorism loss causes yet another concern. For example, the Bishopsgate and St. Mary's Axe incidents were considered terrorism losses, but the subsequent looting and thefts fell under the category of traditional market losses.\footnote{Fleming, supra note 9, at 4. ("Problems with the definition of terrorism could also arise in other ways. For example, consider the London Flood Barrier. Does terrorism occur if extremest destroy this barrier and London is damaged by flood?").} Insurers are also having a difficult time with Pool Re.\footnote{Id. at 5.} While they are able to provide a degree of continued coverage where necessary (with government support), they "have a very diversified client base and an enormous administrative burden for which there is no reward unless they are able to obtain specific fee increases from clients for these services."\footnote{Id. ("One company, for example, has 30 full-time employees working solely on Pool Re issues. When one extrapolates this burden to the many composite insurers and other firms throughout the United Kingdom, one can appreciate the significant administration costs created by this system.")}

\begin{itemize}
    \item Pool Re discounted rates by 40 percent in 1995 and substantially reduced them in 1999. Gross premiums reached a high point in 1994, at £369 million. Since then they have fallen substantially, particularly as rates have been cut. In 2000, Pool Re's gross written premium was £39 million. Despite the claims that have been paid, Pool Re's surplus has grown significantly. As mentioned earlier, at the end of 2000, surplus was approximately £665 million.
    \item Fleming, supra note 9, at 4. ("Problems with the definition of terrorism could also arise in other ways. For example, consider the London Flood Barrier. Does terrorism occur if extremest destroy this barrier and London is damaged by flood?").
    \item Id. at 5.
    \item Id. ("One company, for example, has 30 full-time employees working solely on Pool Re issues. When one extrapolates this burden to the many composite insurers and other firms throughout the United Kingdom, one can appreciate the significant administration costs created by this system.")
\end{itemize}
Another Pool Re problems lies with the policyholder’s ability to get the coverage they desire.\textsuperscript{114} Policyholders must decide whether they require terrorism insure or to continue until the inevitable happens and hope their losses are not great. It is a whole or nothing proposal where a firm that only is interested in covering one portion of its business, but not the others, cannot participate.\textsuperscript{115}

The government could also fund its contingent liability to the pool in a variety of ways. It could charge the pool a premium ..., accumulating a fund it could use to pay for losses. ... [T]he government could fund its losses out of tax revenues, either with or without repayment requirements.\textsuperscript{116} The greatest problem is simply this: If the event that is being insured against happens before the Pool has collected enough premiums, or the premium rate was estimate too low, the Pool’s reserves would be insufficient to adequately cover the act.\textsuperscript{117} If this were to occur, the insurers would be obligated to pay all legitimate claims regardless of whether they recovered funds from the Pool.\textsuperscript{118}

"The ... Pool Re system is not working. [T]he system is failing because it is committed to a reinsurance obligation for which there is insufficient premium in the system to pay claims."\textsuperscript{119} The government, which has proceeded to borrow money to meet existing claims, is only adding to its debt. There is no exit strategy that will satisfy the insurance industry, and indicators show that the government’s "objective is to pass the risk back to the commercial market at the first opportunity."\textsuperscript{120}

VI. THE UNITED STATES ROLE IN BACKING INSURERS

Prior to September 11, states regulate insurance companies, however, after the WTC attacks; the federal government has taken an increased interest in the insurance industry.\textsuperscript{121} Each state has a guaranty funds that kicks in when an act

\textsuperscript{114} Id. at 4.
\textsuperscript{115} Id. ("Unless there were totally separate policies and structures in force prior to the beginning of 1993.").
\textsuperscript{116} Alternative Programs for Protecting Insurance Consumers, Terrorism Insurance, Before the Senate Committee on Banking, Housing and Urban Affairs, United States Senate, (2001) [hereinafter McCool] (testimony of Thomas J. McCool, Managing Director, Financial Markets and Community Investment) p. 10.
\textsuperscript{117} Id.
\textsuperscript{118} Id.
\textsuperscript{119} Fleming, supra note 9, at 4.
\textsuperscript{120} Id.
\textsuperscript{121} Lawson, supra note 14, at 62.
creates losses that the insurance companies cannot cover. "Guaranty funds are not operated by state governments, nor are they funded by public money (i.e., there is no explicit subsidy). [T]he funds were created by statute and operate as part of the insurance regulatory system." But if the system fails, the policyholder is left without options? Who will step in and ensure business owners that they will be reimbursed for their losses?

Many insurance industry executives have supported various recommendations that would rope in the Federal Government as a last resort. Many have suggested the creation of a Pool system similar to the UK's Pool Re. However, Treasury Department officials have had concerns about the government creating and regulating the system. Even if the pool was chartered by an individual state, and federal funds were deposited, there is a concern that at the very least, there would be some federal oversight involved.

President Bush has pushed forward his own plan, and has requested that Congress pass legislation that would support federalizing terrorism insurance.

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123. Id. at 11.
125. Id.
126. Id.

And we need to do something on terrorism insurance, as well. This is an issue that I don't think a lot of Americans understand very well, and we're going to use this opportunity to explain it. I'm going to do my best to explain it. Tom Ridge and Larry Lindsey will follow up. ... [A]nd we have a lack of insurance coverage now as a result of the enemy attack. I don't think they actually sat down and said, gosh, if we attack, we'll affect the insurance industry of America. I think that was an unintended consequence of theirs. But, nevertheless, it was a consequence. And we in Washington must deal with it, and must deal with it in a hurry, because the pace of new construction is dropping dramatically in America. Banks and investors, and others, will not finance construction projects that do not have terrorism insurance. In order to build a project, in order to employ people, you've got to borrow money, and you can't borrow money unless there's adequate terrorism insurance. And that's not being provided today. ... And I expect the Congress to act. ... The Hyatt Corporation has acquired a new site for a 1.5 million square foot office building in downtown Chicago. That ought to be encouraging news. It ought to be encouraging news for my friend, the mayor. It ought to be encouraging news for people who wear the hard hat and work, the ironworkers and the construction workers. But they've got a problem finding terrorism coverage, and so they're not getting financing for the project. Somebody wants to build it; they can't get the money to do it because the insurance isn't available. This project is valued at $400 million; will lead to the creation of 2,500 jobs, if the Hyatt Corporation could get insurance. ... We're worried about charities that may be forced to cut back on services to the needy because of the high cost of insurance. Pension
Without some decision, many policy-holders will feel the bite of not having the proper coverage. Many customers have already faced this problem, including the Miami Dolphins and the New York Giants (two professional football teams in the National Football League) who lost terrorism coverage, and the Mall of America in Minneapolis, "whose premiums have increased tenfold."\(^{128}\)

A December letter from the National Association of Insurance Commissioners (NAIC) President, Terri Vaughan, to Senate leaders Thomas Daschle, D-S.D., and Trent Lott, R-Miss., expressed the concerns of the organization if legislative action is not quickly taken.

The terrorist attacks on our country have created enormous uncertainty in our nation's commercial property and casualty insurance markets. We continue to believe the federal government can and should play a critical, limited role in helping this marketplace adjust to these new market realities. We are aware of the efforts the Senate and the House of Representatives are putting forward to

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funds for teachers and other workers that hold real estate assets may experience lower rates of return because of higher terrorism insurance costs. That affects someone's retirement system. ... The transportation industry will face strains from the lack of affordable terrorism insurance. Secondly, while we're doing everything we can to stop terrorist attacks, the economy must be prepared to handle an attack if they do occur. We spend a lot of time here in Washington sniffing down every lead, looking for every opportunity to run down a clue — somebody might be trying to get us. And I am confident — I know we're doing everything we can, but I can't predict with 100 percent accuracy whether or not another attack won't occur. And, therefore, we better find terrorism insurance because, without it, it would be a catastrophic problem if there is another attack. It would make it really hard for our economy to recover a second time if there's an attack without adequate terrorism insurance. I mean, on the one hand we're talking about jobs, and on the other hand we're talking about recovery if there's an attack. Now, we passed a bill in the House that basically put the federal government as a stopgap for terrorism insurance. Above a certain level of claim, the federal government would step in. And that's important. And now it's in the Senate, and the Senate needs to respond and act. The Senate needs to get this bill done quickly. All they've got to do is talk to people in this room, Republicans and Democrats alike. This isn't a bill that says, gosh, if it passes it'll help somebody's political party. That's not what this is all about. This is a bill that helps workers and helps strengthen our economy. This is an important piece of legislation. I've heard some talk in Capitol Hill that the facts don't justify this type of legislation, the facts don't justify the federal government stepping in as a stopgap. They're not looking at the right set of facts, as far as I'm concerned. And so I expect, for the good of our economy, and for the good of the country, that the Senate act. And I want to thank you all for your interest in this bill, and I ask you to contact members of the United States Senate. We believe there is bipartisan support for this bill. We believe that if it ever makes it to the floor, it passes. And I know that we can work with the House version, if it's somewhat different, to get something done quickly.

\(^{128}\) Id. at 3.
advance this legislation. However, further delay will have a negative impact on insurers and insurance consumers who in this instance are predominantly the nation's business community.

Absent federal assistance, many businesses will be without coverage for future losses related to acts of terrorism. In the event insurance is still available, the costs may be unaffordable for many. Anticipating this possibility, many insurers have asked state regulators to grant terrorism exclusions against future losses. Some carriers are indicating that beginning Jan. 1 they will not renew workers' compensation coverage, a business necessity if an employer is to retain employees. These steps will leave consumers without protection. State insurance regulators must act on these requests in the coming days, and we will be hard-pressed to deny many of these specific requests in the absence of a federal 'backstop.' Otherwise, we would be exposing the industry to potentially unmanageable financial risks that would have consequences industry-wide and among all insurance consumers. For these reasons, we urge action on terrorism insurance legislation this year.129

Diane Koken, NAIC Northeast Chair and Pennsylvania Insurance Commissioner, testified before the United State Senate's Committee on Commerce, Science, and Transportation a month after the WTC attacks.130 She said that the NAIC believed that the federal government should work with the states to create a federal backstop that would be limited in scope and duration in the event of another catastrophic attack.131 While multiple plans are currently being passed between Congressional committees, the NAIC recommendations did not single out any one proposed plan.132 However, it did provide guidelines that the NAIC hoped would be an essential element of any plan ultimately accepted and passed by Congress.133

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131. Id.

132. Id.

133. Id. (Diane Koken listed 19 criteria that the NAIC wished to be taken into consideration before the federal government made a final conclusion to the federal backstop recommendation. They are:

1. Federal legislation in this area should "sunset" at a date certain of limited duration after enactment in order to allow a reevaluation of the need for and design of the program. 2. To take advantage of the substantial experience of state-based insurance regulation, the expertise of the NAIC should be made available to any federal program in this area and consideration should be given to including representatives of the NAIC
Koken said that the insurance industry is well suited to cover the losses incurred from the WTC attacks, stating that the "industry is a $1 trillion business with assets of more than $3 trillion." Two examples of the insurance industry's ability to react to disasters and reimburse policyholders who have incurred losses are Hurricane Andrew and the California Northridge Earthquake. In 1992 Andrew caused $19.7 billion in damages, and in 1994 an

as members of the governing body of such a program. 3. Federal legislation should supplement but not replace other private and public insurance mechanisms where those mechanisms can provide coverage more efficiently. 4. Federal legislation should include clear and non-ambiguous definitions of terrorism to be applied to all policies nationwide. 5. Rates should consider all reasonable factors that can be feasibly measured and supported by theoretical and empirical analysis, including relative risk. 6. Federal legislation should encourage loss reduction and hazard mitigation efforts. 7. State residual market mechanisms and other pooling mechanisms providing coverage should be allowed to participate in any program established by federal legislation but in such a way as to not create incentives for business to be placed in those residual markets. 8. Federal legislation should recognize that terrorism exposures subject insurers to potential "adverse selection," i.e., entities with lower risk are less likely to voluntarily purchase coverage, while those with greater risk are more likely to purchase coverage. If possible, the federal program should encourage the inclusion of both low-risk and high-risk entities to promote greater risk spreading in a way that does not subject risk-bearing entities, including the federal government, to adverse selection. 9. Federal legislation should address coverage and cost for all risks exposed to terrorism, regardless of geographic, demographic or other classification, such as "more-at-risk" or "less-at-risk." 10. There should be a safety net protection, within reasonable limits, for any private program created by federal legislation in the event of the insolvency of the program or its participants. 11. Tax law changes should be encouraged to avoid penalties on and encourage the accumulation of reserves for the portion of terrorism losses insurable in the private marketplace. 12. Federal legislation should not unnecessarily preempt state authority. 13. Federal legislation should encourage individuals and businesses to maintain private coverage for terrorism exposure. 14. Federal legislation should promote or encourage awareness that coverage is available for any property and/or casualty risk that meets reasonable standards of insurability. 15. Federal legislation should encourage or mandate that eligible entities participate in the program or run the risk of losing access to federal disaster assistance. 16. There should be an appropriate balance of the different private and public interests in the governance of regulatory oversight over the program. 17. Federal legislation should recognize the expertise of the states in insurance regulation with respect to such areas as licensing insurers, solvency surveillance, oversight of rates and forms in most jurisdictions, licensing producers, assisting policyholders and consumers during the claim settlement process and performing market conduct examinations. 18. To more efficiently achieve the objectives of any federal terrorism program, there should be coordination of state and federal regulatory responsibilities. 19. Jurisdiction over insurer claim settlement practices should remain with the states.

134. *Id.* at 3.

135. Koken, *supra* note 130, at 3. ("Preliminary loss estimates of $30 billion to $40 billion represent just 3 to 4 percent of the premiums written in 2000.").
earthquake cost $16.3 billion in insured losses. Insurers were able to respond to the tragedy, and customers were reimbursed.\(^{136}\)

The insurance industry and federal government need to work together to create a system that will honor all claims in the event of another terrorist attack. However, as a result of the WTC attacks, many in the industry are concerned about their ability to one, set an appropriate price for future terrorist acts, and two, be able to compensate losses if the act is worse than estimated. "However, even if we conclude that insurers cannot price and, therefore, cannot sell this kind of insurance, defining the nature of the problem facing both the economy and the insurance industry is a critical first step."\(^{137}\)

Recommendations for improving some of the problems insurers are facing after the WTC attacks include establishing a uniform definition of terrorism and creating a temporary federal financial backstop for terrorism insurance.\(^{138}\) The need to make these changes isn’t one that results from the insurance industry not being able to pay for the losses suffered in the September 11 attacks. "The industry is going to pay its loss in the World Trade Center events, [but] if terrorist attacks continue, this is an industry with finite capital."\(^{139}\)

VII. EMERGING PLANS FOR FEDERAL INVOLVEMENT

Several plans emerged to cover losses in the event of another terrorist attack. President Bush’s administration has recommended the creation of a pool system similar to Britain’s Pool Re.\(^ {140}\) Costs, divided between the federal

\(^{136}\) Id.

Following the tremendous losses from Hurricane Andrew, "commercial reinsurers restricted their coverage for windstorms and raised prices. This caused a corresponding reaction from primary insurers, who moved to raise prices, cancel coverage for coastal properties, and increase deductible amounts for consumers having significant hurricane exposure. Within a couple of years, normalcy returned to the reinsurance market, and then to the primary market. The Florida Insurance Department assisted with the recovery of the industry by introducing a moratorium on policy cancellations and beginning the discussion of the need for a state catastrophe pool. The Florida legislature later adopted a Hurricane Catastrophe Insurance Pool that provides a state-based backstop for catastrophic windstorms in Florida. These collective actions have resulted in a robust and competitive market for homeowners insurance in the State of Florida.

\(^{137}\) McCool, supra note 116, at 1, 3.

\(^{138}\) Id. See also Koken, supra, note 130, at 2-3.

\(^{139}\) Hamburger, supra note 124. (Statements of Maurice Greenberg, Chairman and Chief Executive Officer, American International Group, Inc.) (However, this statement seems to contradict the statements made by NAIC N.E. Chair, Diane Koken.).

government and insurers, would be an alternative to the industry’s initial proposal. The White House’s plan would require the federal government to pay 80 percent of the first $20 billion of insured losses resulting from a terrorist. Private insurers and reinsurers would cover the remaining 20 percent. If losses from a terrorist event amassed more than $20 billion in insured losses, the government would pay 90 percent, and insurers would pay 10 percent.\footnote{141} Several of the nation’s largest insurers told the state insurance commissions that this plan would hurt smaller companies... Insurers are ... pushing for some sort of safety net, a terrorism pool to provide reinsurance. The White House rejected this original proposal as ‘anticompetitive’ and ‘too complex’ for the limited time frame.\footnote{142}

Two prevailing bills are in Congress, each passed in their respective chambers. The House of Representatives passed the Terrorism Risk Protection Act (H. R. 3210) in November. House Financial Services Committee Chairman Michael G. Oxley said, “the bill establishes a temporary risk-spreading program to shore up the insurance market and provide it with needed confidence and certainty. The legislation requires little government regulation and would only kick in if a terrorist event occurred.”\footnote{143} Passed in the House in November 2001, H.R. 3210 would provide for the federal government to cover casualty and property damages resulting from terrorist attacks.\footnote{144} The government, over two years, would cover 90 percent of any losses resulting from a terrorist act, and private insurers would cover the last 10 percent.\footnote{145}

Federal aid would be triggered by industry-wide losses of at least $1 billion or 10 percent of the capital and surplus of any individual company. The aid would be ... a loan to be repaid by the industry

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\footnote{141}{Federal Government, Insurers Debate Plan to Cover Future Terrorist Acts, supra note 140. (“After three years, the government would withdraw, allowing private insurers to take over.”).}
\footnote{142}{Id.}
\footnote{144}{144. Insurance Liability, supra note 16.}
\footnote{145}{Id.}
through assessments spread across the companies over an extended period of time.146

The Terrorism Risk Insurance Act (S. 2600), the rival bill to H.R. 3210, was passed on the Senate floor on June 18, 2002.147 The bill, sponsored by Sen. Chris Dodd (D-Conn.) and cosponsors Senate Majority Whip Harry Reid (D-Nev.), Senate Banking Committee Chairman Paul Sarbanes (D-Nev.) and Sen. Charles Schumer (D-N.Y.), would “trigger if a terrorist attack caused at least $5 million in damages. The federal government would then pay 80 percent of losses above each individual company’s deductible for losses of up to $10 billion.”148 The Act requires insurance companies to cover terrorist acts if the resulting damage is up to $10 billion. “The federal government would cover 90 percent of losses greater than that amount during the first year of the possible two-year program. If the Treasury secretary approves the program for a second year, the threshold would rise to $15 billion.”149

These two bills are very different. The House bill is a “loan” program.150 In the aftermath of a terrorist attack, the federal government would loan insurers up to $100 billion, but only after private insurance companies paid the first $1 billion.151 The insurers who received the federal loan monies would be required to repay the federal government, most likely pulling from earnings and premium increases. This will likely cause customers to pay higher premiums.152

Senate 2600 is a federally funded, short-term federal backstop program,153 that

[substantially increases ... deductibles ... the industry ... pay[s] before tax dollars are used to pay for losses ... [thereby] ensur[ing]

146. Id.
149. IIABA, supra note 147, at 2. (“The bill also includes a per-company market share retention formula that would enable companies to be eligible for the federal backstop even if losses do not surpass the yearly, per-event thresholds.”).
150. Id.
151. Id.
152. Id.
that insurance companies will do all ... they can to protect ... taxpayers ... through careful assessment of the risks involved with each policy and the promotion of risk mitigation by their customers.154

"Among other differences, S. 2600 leaves property owners susceptible to punitive damages resulting from a terrorist attack. The ICSC and President Bush himself have voiced opposition to placing limits on punitive damage coverage for property owners, and Bush must sign the final bill."155 President Bush will veto any terrorism insurance bill that "allows punitive damages to be assessed against United States businesses."156

H.R. 3210 and S 2600 both require losses, either aggregate industry losses or from individual company losses, to reach a trigger level before federal monies will be disbursed, both of which are capped at $100 billion.157 H.R. 3210 has two triggers; the primary trigger starts when annual insured losses resulting from terrorist attacks reach $1 billion.

When this occurs, all participating insurers can receive disbursements. If terrorist attacks cause damages exceeding $100 million "and losses for at least one insurer exceed both 10 percent of surplus and 10 percent of commercial lines net written premium, then those specific insurers who are so affected are eligible for payments"158 under the bill's second trigger.

Once the main trigger of $1 billion is reached, insurers are reimbursed for 90 percent of their losses above a $5 million deductible. In the case of the secondary trigger, eligible insurers are reimbursed for 90 percent of their losses in excess of 10 percent of their net written commercial lines premiums.159

Under S. 2600, insurers are limited to what they can recover. Insurers are limited to collecting losses, resulting from terrorist attacks, that exceed a deductible equal to their commercial insurance market share times $10 billion,

155. Senate Passes Terrorism Insurance Bill, supra note 153.
158. Id.
159. Id.
which is limited to $15 billion in the second year.160 “In the case of S 2600, the federal share of losses is 80 percent of losses in excess of the individual company deductible, until losses reach $10 billion. Thereafter, the federal share is 90 percent.”161

Under H.R. 3210, insurers would be reimbursed $3.81 billion a year. Under S 2600, insurers would receive $1.76 billion for the first year, program and $1.44 billion the second year. If these plans began July 1, 2002, the expected disbursements over five years under H.R. 3210 would be $6.6 billion versus $2.8 billion for S 2600.162

H.R. 3210 requires ... disbursements ... be recovered via assessments and surcharges, while S. 2600 does not. Under H.R. 3210, the first $20 billion ... are to be recovered via assessments on commercial insurers; ... disbursements in excess of $20 billion ... to be recouped via earmarked surcharges on commercial insurance policies.163

“In theory, the federal government should ultimately be able to recoup the majority of any disbursements under H.R. 3210. Over an extended period the only limitation on recoupment would be due to unrecoverable assessments on insolvent insurers.”164 Overcoming the differences between H.R. 3210 and S. 2600 will be a major hurdle that both the House and Senate may have difficulty negotiating as the one-year anniversary of the WTC attack draws closer.

VIII. CONCLUSION

While Great Britain’s Pool Re is a valuable system to assist the insurance industry in the event of massive damages resulting from terrorism, it is not the best program for America.

160. Id.
161. Id.
162. Lowe, supra note 157, at 3.
163. Id. at 6.
164. Id.

Except for the first $5 billion of disbursements, assessments and surcharges in any calendar year are limited to 3 percent of commercial lines net written premium, which translates to an industry-wide overall annual dollar cap on recoveries of roughly $3.6 billion, based on our estimate of commercial lines direct written premium of $120 billion. In addition, H.R. 3210 provides the Secretary of the Treasury with considerable latitude regarding the timing and administration of any assessments or surcharges. For example, the Secretary may defer assessments on individual insurers to the extent that the Secretary determines that a deferral is necessary to avoid insolvency. Similarly, before imposing any surcharges, the Secretary is required to assess commercial insurance market conditions and consider the impact of the surcharges on affordability of commercial insurance.
The United States insurance industry will survive the short-term effects of September 11. It does not, however, have the capacity to protect against another terrorist act of similar magnitude. … Until terrorism risk is eliminated or greatly reduced, United States businesses … will need [the federal] government to … ensure … effective commerce … continues.¹⁶⁵

It will ultimately be a compromise of three principles; the willingness of the federal government to come to the aid of the insurance industry under H.R. 3210, the guarantee of a federal backstop that will be the cornerstone of terrorism insurance under S. 2600, and the willingness of our elected officials to overcome political maneuvering that will ultimately decide the fate of terrorism insurance. Between these, the ability of insurers and reinsurers to meet the losses of their policyholders will be met. As the fall session of Congress looms, attention from the insurance industry, policyholders, and the media will be directed at lawmakers who struggle to find a compromise that will ensure federal involvement and provide consumer confidence.

¹⁶⁵. Lowe, supra note 12, at 1.