Countering the Changing Threat of Terrorism

The *2016 Global Terrorism Index* reported a 650% increase in terrorism related deaths across OECD countries.[1] In Australia, more than a dozen major terrorist plots have been foiled by counter-terrorism agencies since the national threat level was raised to *probable* in 2014.[2] But while the threat of terrorism in developed countries continues to climb, it is the shifting nature of these terrorism events that is pushing the insurance industry to reassess cover for these risks.

Many of the atrocities witnessed so far in 2017 – London, Manchester, Paris, Stockholm, St Petersburg, Las Vegas – all bear the hallmarks of "lone wolf" attacks or "lone attacker" events. Typified by being small-scale, and causing high loss of life but limited property damage, these events can leave devastating effects on an organisation's operations, assets, people and day-to-day running of the business.

The increased frequency of these incidents also brings a challenge to businesses, particularly where losses are not fully recoverable from insurance, or may fall into the "grey" area between a claimable and non-claimable loss under traditional insurances.

TRADITIONAL TERRORISM COVER AND THE ARPC

The Australian insurance market has largely relied on the Australian Reinsurance Pool Corporation ("ARPC") reinsurance scheme in providing terrorism cover to eligible policyholders.

The scheme, which currently holds $13b in aggregate limit, aims to relieve the insurance market of terrorism related material damage, business interruption and public liability losses.[3]

1 Institute for Economics & Peace, *Global Terrorism Index 2016*

2 Federal Minister for Justice (2016, December 23), Press Conference, www.pm.gov.au/media/2016-12-23/joint-press-conference-minister-justice-hon-michael-keenan-mp-and-australian

3 www.arpc.gov.au/about-arpc

HOW DOES THE ARPC WORK?

In the event of a *declared* terrorist incident, any terrorism exclusions under an eligible insurance contract are overridden and insurers must pay their claims in accordance with the terms and conditions of the policy. The respective insurers can then access the ARPC scheme to recover their eligible terrorism losses, subject to various thresholds.

In Australia, an incident needs to be formally declared as a terrorist incident by the responsible minister before provisions under the ARPC are triggered. Cover under the ARPC follows traditional "damage-based" concepts, meaning that a business interruption loss is only covered if it follows property damage.

The evolution of terrorism acts, which has shifted focus from terrorist groups targeting high value properties to lone attackers seeking maximum casualties in crowded spaces, means that many events are now likely to fall outside the boundaries and definitions of traditional insurances.

IS COVER PROVIDED UNDER THE ARPC ADEQUATE?

Taking into consideration the number of buildings and businesses that may be affected by a catastrophic event or multiple events, the total loss could potentially exceed the ARPC aggregate pool. In such a scenario, payouts would be capped in accordance with a reduction percentage set by the responsible minister, which effectively reduces the level of cover available for each eligible policyholder.

The ARPC is reviewed every three years to assess its appropriateness and adequacy. The latest review broadened the scheme's scope of eligibility to include certain mixed-use residential buildings[4] and high value buildings.[5]

The ARPC also broadened the scope of a terrorism act to include chemical, biological, polluting, contaminating, pathogenic and poisoning.[6]

Marsh's National Property Placement Manager, Mark (Mitch) Mitchell, believes that while the latest round of amendments is good news to those organisations that have since become eligible, the flipside is dilution of cover: "The total aggregate cover is effectively being shared with more policyholders now, which potentially dilutes the cover for everyone. This is something businesses should consider when assessing their terrorism risk exposure and the adequacy of the cover offered under the ARPC."

Mitch goes on to explain: "A certain level of uncertainty surrounds the ultimate level of cover provided to the policyholder. Delays could arise waiting for an incident to become a *declared* terrorist incident, as well as the time it takes to determine the quantum of a significant property or business interruption loss. There is also potential to have several significant events which cumulatively exceed the limit of cover provided by the ARPC."

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>
> **MARK MITCHELL**
> NATIONAL PROPERTY PLACEMENT MANAGER, MARSH

4 Where at least 20% of the building floor space is being used for commercial purposes, and the sum insured is less than $50m.

5 Where the sum insured is $50m or more.

6 www.arpc.gov.au/2017/04/04/terrorism-insurance-scheme-amendments-approved

PROTECTING YOUR BUSINESS AGAINST TERRORISM EXPOSURE

Terrorism risk will continue to shift and evolve, necessitating the development of new and appropriate products that continue to stay relevant. The following is an overview of a number of risk transfer options currently available in the insurance market and the types of situations for which they might be suitable.

TOP-UP TERRORISM COVER

What is it? "Top-up" terrorism insurance provides an additional layer of protection on top of the ARPC cover. Unlike the ARPC limit, which is shared amongst all members of the scheme, the top-up limit is a dedicated limit reserved exclusively for the individual policyholder. Top-up insurance aims to cover claim payout shortfalls that result from the aggregate nature of ARPC's cover.

Who may be interested? Organisations that desire extra protection rather than relying solely on the ARPC cover in the event of a major loss event where a payout reduction may be applied, property owners with accumulation exposure as a result of concentration of assets (eg. located in CBD areas).

WRAP-AROUND TERRORISM COVER

What is it? These global programs are designed to "wrap around" country-specific government terrorism pools (eg. ARPC in Australia, POOL RE in UK, TRIPRA in US). The policy can provide difference in conditions (DIC) cover where a government terrorism pool is in place in a particular country as well as ground-up cover in the absence of a government pool (eg. New Zealand, Canada).

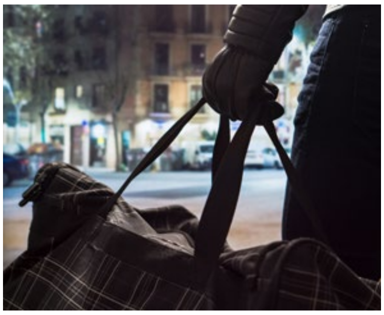
Who may be interested? Organisations with multinational exposures, for example, Australian based businesses with global assets and operations, and New Zealand based businesses with assets predominantly in New Zealand and/or with overseas exposures.

STANDALONE TERRORISM COVER

What is it? A standalone terrorism policy provides cover to the policyholder from ground up. Although the aggregate limit of cover attainable under a standalone policy may be less than the ARPC, it provides a dedicated limit for the policyholder, in contrast to the shared limit provided under the ARPC.

Who may be interested? Organisations that are not eligible for the ARPC (including government owned properties, residential/strata properties, some mixed-use buildings that fall outside of ARPC's scope, rolling stock, vehicles).

Active Assailant Event cover does not require the attack to be formally declared a terrorism event, nor does the attacker need to have a political motivation.



ALTERNATIVE COVERS

The potential cost of property damage from a "small" attack can be outweighed by business interruption costs if, for example, enforced curfews resulted in diminished patronage, travel warnings led to cancellations, and grounded flights caused travel disruption.[7]

In response to these shifting threats, the insurance market has developed crisis management style insurance products to supplement gaps that may exist under traditional insurances and the ARPC. They aim to address issues like active shooter situations, non-damage losses such as costs incurred from evacuation due to a threat, contingent interruption of operations, cancelled reservations and loss of attraction.

What is it? Examples of cover include[8]:

- **Active Assailant Event cover:** Cover is triggered by a malicious physical attack by an "active assailant". The attacker does not need to identify with a terrorist organisation nor have a political motivation. Likewise, the attack does not need to be formally declared a terrorism event in order for the policy to respond. Non-damage business interruption cover is available under the policy including closure of premises by authority, denial of access, additional expenses for public relations, relocation, counselling, medical, recruitment, retraining and security – some of which offer both first and third party cover.

7 Marsh 2016 Terrorism Risk Insurance Report, July 2016

8 Based on XL Catlin's *Active Assailant Event, Loss of Attraction, Threat of a Malicious Act (ALT)* insurance policy

- **Threat cover:** Cover is triggered by a threat of a malicious act to cause property damage or bodily injury at the policyholder's premises or towards a person. For example, during the Sydney Lindt Café siege (2014), police ordered evacuation at the Opera House, Town Hall and the Martin Place tunnel due to reports of bomb threats at those locations. Non-damage BI costs, such as lost turnover and additional expenses including consultancy fees from managing reputational damage and public relations or improving security measures against future threats, are some of the costs that may be recoverable under this insurance.

Who may be interested? Organisations that are not eligible under the ARPC or those seeking extra protection. According to Lisa Hiscock, Crisis Management Underwriter at XL Catlin, the biggest buyers of these alternative covers to date have been medium-sized retailers and higher education organisations, followed by hospitals.

"We are seeing many small and medium-sized companies opting to transfer terrorism related risks to insurance. A lot of these companies don't have a comprehensive crisis management response plan nor do they have adequate resources to manage or mobilise such a plan. Consequently, we've seen a growing demand for external risk consultancy support to help these businesses plan for the risks in an effort to prevent and minimise their impact." explains Hiscock.

At the other end of the spectrum, the take-up rate of alternative covers has been slower among larger organisations. Zaheen Singh, National Real Estate Practice Leader at Marsh, explains that most high-end retailers and large companies already have systems in place and budgets set aside to respond to crisis situations.

"From our experience, these companies have shown interest in the alternative covers, and look to strike the optimum balance between risk transfer and self-insurance options, coupled with a review of business continuity plans to ensure they remain relevant." says Singh.

WHERE TO FROM HERE?

Standalone and alternative terrorism insurance options appear under-utilised in Australia. Although there is ample capacity in the insurance market, a number of factors may be influencing local purchasing patterns:

- Organisations' general perception of terrorism risk across Australian cities as being low (compared to American, European and Middle Eastern cities)
- Businesses are operating in a very cost sensitive environment
- General reliance on the government-managed pool, ARPC

Notwithstanding these factors, terrorism will continue to be an evolving global risk in a digital age where geographic reach is no longer limited by physical borders, and an uncertain terrorism risk landscape is underpinned by unstable global political and economic environments.

In this environment, it is prudent for organisations to review their response plan in a terrorism scenario, be aware of their exposures, and have a clear understanding of their insurances, particularly for those who are not eligible under the ARPC or have overseas exposures that may leave them uninsured.