Policyholders Face Uncertainty after Lapse of Terrorism Risk Insurance Program

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Congress' failure to renew the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA), a 2007 extension of the 2002 Terrorism Risk Insurance Act, could have significant implications for companies that rely upon property or casualty policies to manage risk. TRIPRA expired on December 31, 2014, potentially triggering policy endorsements that exclude coverage, previously provided under those policies, for loss or damage arising from acts of terrorism. Standard property and casualty policies issued as of January 1, 2015 will also likely exclude such coverage now that carriers can no longer rely upon TRIPRA, under which the federal government bore a significant portion of insured losses caused by terrorism. It remains to be seen whether insurance carriers will offer terrorism risk insurance going forward, how such coverage will be priced if it is available, and whether the new Congress will extend the Terrorism Risk Insurance Act. In all events, policyholders should understand what TRIPRA's expiration means for risk management purposes and what should be done unless and until Congress acts.

Origin of Terrorism Risk Insurance Program

The 9/11 terrorist attacks in New York, Washington, D.C. and Pennsylvania caused tremendous financial stress on the insurance industry, causing an estimated $40 billion in insured losses. Following the attacks, many insurers and reinsurers withdrew from the market. Endorsements excluding coverage for loss or damage caused by terrorism became standard in many commercial property and casualty policies. As a result, terrorism risk insurance became largely unavailable and very expensive.

In response, Congress enacted the Terrorism Risk Insurance Act in November 2002 as a federal backstop for insurance claims arising from certain acts certified as "terrorism" by the U.S. Secretary of Treasury. The act established the Federal Terrorism Insurance Program, described by the U.S. Department of Treasury as a "system of shared public and private compensation for insured losses resulting from acts of terrorism." Under this system, insurers were required to offer terrorism coverage under commercial policies, and in return, the federal government promised to cover a significant share of covered losses. The Terrorism Risk Insurance Act was set to expire in 2005, but was reauthorized by Congress for another two years. In 2007, Congress extended the program again, under TRIPRA, until December 31, 2014.

The Terrorism Risk Insurance Act applied to commercial lines of property and casualty insurance, including excess insurance, workers' compensation, and directors and officers liability insurance. Excluded lines include crop insurance, private mortgage insurance, title insurance, financial guaranty insurance, medical malpractice insurance, health or life insurance, flood insurance, reinsurance, commercial auto, and burglary and theft.

A bill to extend the Federal Terrorism Insurance Program beyond 2014 wound its way through Congress last year, and what appeared to be a final version passed the House of Representatives in early December. The Senate adjourned, however, prior to voting on the bill such that TRIPRA, and the program it authorized, expired on December 31, leaving it to the newly elected Congress to take up the matter this year.

Ramifications of TRIPRA's Expiration

An obvious potential consequence of TRIPRA's expiration is the return to an insurance marketplace where coverage for losses arising from terrorism becomes largely unavailable, more costly, or both. Other, less obvious, consequences are more immediate and of particular concern for policyholders.

Many property and casualty policies currently in force that provided terrorism coverage when they were issued may no longer provide such coverage. This is because many of those policies include an endorsement, commonly designated as the "Conditional Exclusion of Terrorism Endorsement," which conditions terrorism coverage upon the existence of the Federal Terrorism Insurance Program. The endorsement arguably provides that if that program lapses, the exclusion is automatically triggered, eliminating coverage for "loss or damage caused directly or indirectly by terrorism . . . ." The standard form of this exclusion applies to acts of terrorism involving use of a nuclear device, release of radioactive material, application or dispersal of pathogenic or poisonous biological or chemical materials, or where the total insured damage sustained by all different types of property of all persons affected by the terrorist act exceeds $25 million.

Although use of these endorsements is widespread, it is not universal. Generally, insurance carriers must obtain state regulatory approval before issuing policy endorsements excluding or limiting coverage. After the 9/11 attacks, most states quickly authorized carriers to include the Conditional Exclusion of Terrorism Endorsement. New York and Florida, however, have never approved their use.

TRIPRA's expiration is of particular significance for businesses and organizations that are required to maintain terrorism insurance under financing or lending agreements. Such entities may include those in the hotel, tourism, sporting and concert industries, large commercial and industrial centers such as high-rise office buildings and major shopping centers, commercial real estate developers, universities, amusement parks and other entertainment attractions. Foregoing terrorism risk coverage may not be an option for these entities.

What to Do

Until the new Congress acts, it is impossible to predict whether it will revive the Terrorism Risk Insurance Program. Even if Congress does reauthorize the program, it may take months to do so and the new legislation could contain significant changes to the now-expired law. In the meantime, policyholders should take immediate steps, if they have not already done so, to mitigate the effects of TRIPRA's expiration.

1. Policyholders should review their property and casualty policies to determine if they include the Conditional Exclusion of Terrorism Endorsement, or similar endorsement or policy exclusion. If they do, policyholders will have to decide whether they are able, or willing, to forego such coverage.

2. Businesses and organizations that want terrorism coverage, or are required to maintain it, should negotiate with their current carriers to obtain it. For an additional premium, the carrier may be willing to amend the policy currently in force to add coverage or remove or modify any endorsement that either excludes coverage or conditions it upon the maintenance of the Terrorism Risk Insurance Program.

3. If a policyholder's current carrier is unwilling to provide terrorism risk coverage, the policyholder should look into standalone coverage from a different carrier. Companies should be aware, however, that standalone coverage may be expensive and of limited availability. Last April, Marsh reported that 48% of property insurers interviewed indicated that they would not offer standalone terrorism coverage if TRIPRA expired. Policyholders, therefore, may need to purchase multiple layers of coverage from various carriers, rather than a single policy with large limits.

4. Policyholders should keep in mind that "stop gap" coverage may only be required for a relatively short period, if Congress quickly passes legislation that revives the Terrorism Risk Insurance Program without substantial alteration. Because such coverage could be expensive, companies should refrain from locking themselves into contracts that provide coverage for an extended period.

5. Be aware that reauthorization of the Terrorism Risk Insurance Act might not nullify a Conditional Exclusion of Terrorism Endorsement. As indicated, the standard form of that endorsement provides that the terrorism exclusion is triggered if TRIPRA lapses. But the exclusion is also triggered if Congress renews or replaces the now-expired program with one that (1) increases the amount the insurer must pay for covered losses, (2) decreases the federal government's share of those losses, (3) redefines "terrorism," or (4) makes insurance terrorism coverage "subject to provisions or requirements that differ from those that apply to other types of events or occurrences under the policy." Policyholders, therefore, need to understand any new terrorism risk insurance legislation that Congress passes to determine whether their current policy, or one they are about to purchase, includes a Conditional Exclusion of Terrorism Endorsement that is triggered by that new legislation.

6. Policyholders that currently have a standalone terrorism insurance policy should review it carefully to determine whether, and under what conditions, the insurance carrier may cancel the policy. Without the federal backstop provided under the Terrorism Risk Insurance Program, carriers might refuse to bear any additional risk of loss imposed by TRIPRA's expiration and attempt to avoid that risk by invoking the policy's cancellation provisions.

7. Captive insurers were eligible for support under the Terrorism Risk Insurance Program, so they are not immune to the potential consequences of TRIPRA's expiration. Because captives are essentially a form of self-insurance, where the insurer is usually a wholly owned subsidiary of the insured or of the insured's corporate parent, the insured should determine whether the captive insurer is adequately capitalized to bear the additional risk it may face now that the Terrorism Insurance Program has lapsed.

Terrorism risk coverage for property and casualty losses remains an important aspect of risk management for many policyholders. Congress' failure to reauthorize the Terrorism Risk Insurance Act, therefore, may have significant ramifications for certain policyholders. Just how significant is still unknown. Whether your business is considering its options in light of TRIPRA's expiration, or is required to protect itself through terrorism risk coverage, Proskauer's Insurance Recovery Group can help you work through your insurance issues.

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