TERRORISM INSURANCE COVER FOR COMMERCIAL PROPERTY

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BACKGROUND

The *Terrorism Insurance Act 2003* is the Commonwealth's response to the substantial withdrawal of insurance cover for terrorism risk that took place in the wake of the attacks on the USA on 11 September 2001.

COVER FOR TERRORISM RISK

The *Terrorism Act* operates by writing back terrorism exclusion clauses in commercial property insurance contracts in relation to loss from declared terrorist incidents. Insurers may, if they wish, in turn reinsure this risk with the Australian Reinsurance Pool Corporation (ARPC).

The liability of the Commonwealth is effectively limited to $10.3 billion.

The legislation regulates insurance contracts covering:

- loss or damage to property owned by the insured;
- related business interruption etc. for owned or occupied by insured; and
- liability arising from being an owner or occupier.

A declared terrorist incident is a terrorist act which is declared by the Treasurer. A terrorist act is an action or threat made with the intention of advancing a political, religious or ideological cause by coercing or intimidating a section of the public.

Two important caveats need to be borne in mind. Not all acts are terrorist acts. A terrorist act:

- must have happened in Australia; and
- does not include an act of war.

THE SCHEME OF THE LEGISLATION

The premiums that insurers pay contribute to an expected pool of $300 million. This pool will be available to cover claims from declared terrorist incidents. The pool will be supplemented by a:

- back-up line of credit of $1 billion underwritten by the Commonwealth; and
- Commonwealth government indemnity of $9 billion.

The premiums for reinsurance depend on the class of insurance coverage and the location of the property. It is anticipated that premiums will range between 2% and 12% of the underlying premium averaging 5%.

Insurers are not able to reinsure all of the risk: they must retain a risk to the lesser of $1 million revenue or 4% of gross fire/ISR premium per insurer per annum and $10 million across the industry per event. If there is a significant claim on the scheme, the premiums paid by insurers can be increased.

The Government intends to keep the scheme in place for only as long as it takes for adequate commercial terrorism risk insurance to re-emerge in the insurance market.

COVERAGE

The scheme 'piggybacks' the existing and future policies. Therefore a policy holder is only covered for terrorism related losses under the heads of damage for which they are already insured (e.g. fire, flood, business interruption etc.). For example, if a terrorist act caused a fire, then a policyholder would only be able to claim for subsequent loss if their insurance policy would normally cover damage from fire.

Losses arising from the hazardous properties of nuclear material are excluded from coverage.

COMMENCEMENT

Whilst the scheme starts on 1 July 2003, due to the lead time needed by insurers to effect system changes, ARPC will only start collecting reinsurance premiums for eligible insurance contracts entered into on or after 1 October 2003.

EXCLUDED INSURANCE CONTACTS

Certain contracts of insurance are excluded. These include: private residential property insurance; health insurance; motor vehicle insurance; life insurance; private mortgage insurance; professional indemnity insurance; and insurance contracts that cover Commonwealth, State and Territory Governments.

The compete list of excluded contracts can be found in Schedule 1 of the Regulations.

CLAIMS PROCESS

The diagram below shows how a claim might be paid.

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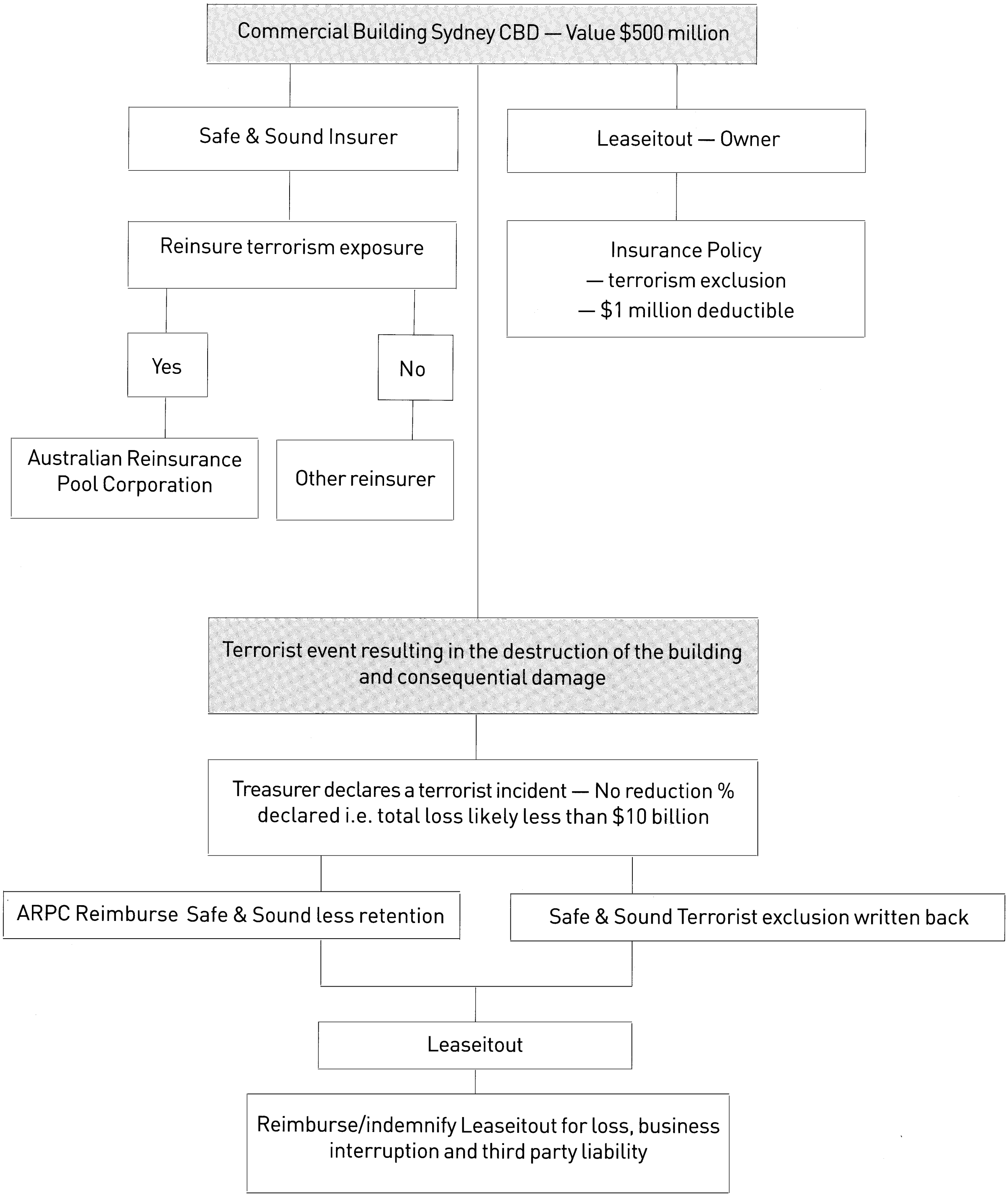
Commercial Building Sydney CBD — Value $500 million
Safe & Sound Insurer
Leaseitout — Owner
Reinsure terrorism exposure
Insurance Policy
— terrorism exclusion
— $1 million deductible
Yes
No
Australian Reinsurance Pool Corporation
Other reinsurer
Terrorist event resulting in the destruction of the building and consequential damage
Treasurer declares a terrorist incident — No reduction % declared i.e. total loss likely less than $10 billion
ARPC Reimburse Safe & Sound less retention
Safe & Sound Terrorist exclusion written back
Leaseitout
Reimburse/indemnify Leaseitout for loss, business interruption and third party liability