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TERRORISM AND ITS IMPACT ON SMALL INSURERS

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When you start practicing law and you need to find out where to make a claim against somebody injured by an uninsured motorist, that's when you would seek out the Motor Vehicle Accident Indemnification Corporation.¹ Many lawyers are unaware of MVAIC's existence. Prior to joining the Robert Plan, I spent 25 years with the New York State Insurance Department, serving as a Chief Examiner in the Property and Casualty Insurance Bureau. I have spent most of my career working on the availability and affordability of property and casualty insurance products, particularly automobile insurance.

I was privileged to work with Dick Thomas in 1985 when New York had its property and liability insurance crisis, quite a more severe crisis than we have today with terrorism. Interest rates went from 20% to 6% overnight² and insurance companies realized very quickly the need to really raise the prices of its products. There was wholesale withdrawal from markets and many towns and cities could not get insurance, including my town of Port Jefferson. Mr. Thomas' company AIG stepped up to the plate and wrote my town and a lot of other towns. Prisons could not get insurance so we put together a pool. Mr. Thomas'

* These remarks are an actual transcript of the author's comments at the St. John's Journal of Legal Commentary Symposium on Mar. 14, 2003.

¹ See N.Y. INS. LAW §§ 5201-5225 (1985) [hereinafter MVIAC] (establishing Motor Vehicle Accident Indemnification Corporation), available at <http://assembly.state.ny.us/leg/?cl=52&a=35> (last visited, Jan. 19, 2004); see also MOTOR VEHICLE ACCIDENT INDEMNIFICATION CORPORATION WEBSITE (explaining MVAIC purpose and eligibility), at <http://www.mvaic.com/index.htm> (last visited, Jan. 19, 2004).

² See generally Albert B. Crenshaw, *For Insurers, a 'Slippery Slide' Into a Slump; Rates Slashed as Industry Enters 'Soft' Cycle*, WASH. POST, June 11, 1989, at H1 (describing 1985 insurance crisis and sudden downturn in interest rates); Leslie Wayne, *Insurance Industry Under Fire*, N.Y. TIMES, June 9, 1986, at D1 (outlining insurance crisis of 1985 and industry response in wake of interest rate decline).

company was the major underwriter of the Pool and I believe AIG ran a 20% loss ratio.

September 11, 2001 is a day that I think most of us will never forget. I know I wont, I lost six close associates and a former superintendent; Neil Levin was one of the victims of the World Trade Center. The Insurance Department used to be located in the World Trade Center. In fact, I had a nice corner office on the 80th floor of the south tower, and had the Insurance Department not been kicked out so that commercial enterprises could go into the World Trade Center, I would have been looking at the plane coming at me in the south tower. So I will never forget that day, and hopefully, it will be the only such incident in all our lifetimes.

The Terrorism Risk Insurance Act ("TRIA")³ applies to commercial insurance.⁴ It does not apply to personal lines,⁵ such as homeowners,⁶ and private passenger automobile.⁷ Commercial Mutual Insurance Company is a small insurance company and there are thousands of small insurance companies in the United States that write small commercial lines business, homeowners, and private passenger auto. Small insurers have been severely impacted by 9/11 and the terrorism issue. The first impact on my company after 9/11 was that the whole reinsurance market dried up, not just for terrorism coverage, but for all coverages because reinsurers had lost alot of surplus.⁸ While reinsurers do reinsure companies like AIG and other companies, their financial capacity to underwrite major losses was not adequate. The World Trade Center loss was an enormous hit on them, and I think they panicked. Capacity in the reinsurance market dried up and all

³ See Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, § 201, 116 Stat. 2322 (2002) [hereinafter TRIA] (providing for TRIA); see also TERRORISM RISK INSURANCE PROGRAM, U.S. Dept. of Treas. (explaining TRIA and providing links to further resources), at <http://www.ustreas.gov/offices/domestic-finance/financial-institution/terrorism-insurance> (last visited Jan. 19, 2004).

⁴ See generally Robert P. Hartwig & Claire Wilkinson, *Terrorism Insurance*, INS. INF. SERIES VOL. 1/NUMBER 3, at 5-6 (Aug. 2003) (outlining industry reaction to September 11 and effect of TRIA), available at http://server.iii.org/yy_obj_data/binary/743343_1_0/Terrorism.pdf (last visited, Jan. 19, 2004).

⁵ See *id.* (discussing application of TRIA and exclusions, including commercial lines).

⁶ See *id.* (discussing application of TRIA and exclusions, including homeowner insurance policies).

⁷ See *id.* (discussing application of TRIA and exclusions, including private passenger automobile policies).

⁸ See *id.* at 7 (explaining that reinsurers are not in position to assume anywhere near as much terrorism risk as they did on September 11).

small companies that depend on reinsurance suddenly had a huge problem. In the first renewal after 9/11 the coverages that were available for any kind of business were severely restricted and ceding commissions were much reduced. Reinsurers no longer wanted to take risk and that is their major function. The increased cost of reinsurance is going to have an impact on what you pay for auto insurance and homeowners insurance. It is impossible for my company to obtain reinsurance for private passenger auto, and where is the connection between private passenger auto losses and terrorism?

The next impact, when I examined my treaty renewal (reinsurance agreement) that I received January 1, 2002 was the addition of an absolute exclusion for terrorism. The exclusion simply read, this treaty does not cover your company for any act of terrorism, period. Superintendent of Insurance Serio, at the same time, issued a directive that no primary insurance company in New York is permitted to exclude terrorism.⁹ So being a CPCU and knowing that I'm supposed to deal with all my exposures, and since Commercial Mutual insures twelve thousand homes in the metropolitan area, and about three or four thousand trucks, I thought well, I'm now in a position where I cannot get reinsurance for terrorism losses, yet I have to cover such losses in full. In addition, insurance policies, generally, and especially homeowners' policies are all risk policies.¹⁰ It covers everything except what is specifically excluded.¹¹ Hence, if I do not exclude it, it is covered. Quite a dilemma for a small insurer caused solely by the position of the Superintendent.

Thirty-eight states have allowed terrorism exclusions, but New York will not.¹² I applied for a terrorism exclusion and I got a

⁹ See Circular Letter No. 25 from Gregory V. Serio, Superintendent, N.Y. S. Ins. Dept., to All Property/Casualty Insurers and Rate Service Organizations Doing Business in New York State, New York Property Insurance Underwriting Association, State Insurance Fund, New York Automobile Insurance Plan, and Excess Line Association of New York (Dec. 23, 2002) (issuing guidelines which prohibit terrorism exclusion), available at http://www.ins.state.ny.us/cl02_25.htm (last visited Jan. 19, 2004).

¹⁰ See generally Douglas G. Houser & Linda M. Bolduan, *Mold: Another Four-Letter Word Every Coverage Attorney Needs to Know*, 38 TORT & INS. L.J. 15, §1 (2002) (validating homeowners' policies as all risk policies because they cover direct physical loss to property).

¹¹ See *id.* (confirming exclusions must be expressly stated in the insurance policy).

¹² See generally *Lack of NY Terror Accord 'Harmful'*, INS. DAY, Jan. 15, 2002, at 1 (emphasizing New York has not approved the terrorism exclusions on commercial policies).

response from the Insurance Department that it is against public policy to exclude terrorism.¹³ But it is not against public policy for a reinsurer to exclude terrorism?¹⁴ Surplus lines companies, the non-licensed companies in this state, are also permitted to exclude terrorism.

The market has softened up a little bit. In July 2002, I was able to get a terrorism exclusion that covered terrorism with the exception of any events caused by nuclear, biological or chemical means. So I'm still exposed. Small insurers and medium-sized insurers are between a rock and a hard place. They cannot exclude terrorism as a matter of public policy, but reinsurers can exclude it from their coverage. There is a section of the Insurance law in New York that says an insurance company cannot expose more than ten percent of its surplus to any one risk.¹⁵ However, for terrorism, one hundred percent of its surplus is exposed. So my company, and many other insurance companies in this state are being placed in a position of violating that section of the law.¹⁶

I have always thought, what if the worst-case scenario happens and I get this huge terrorism loss and I do not have the ability to pay it? I have no reinsurance for it. I have thought about using an existing exclusion in the policy excluding war or warlike actions.¹⁷ Of course, it is a war on terror;¹⁸ I hear that on TV all the time.

I can give you two examples of potential personal lines terrorism losses. Right after 9/11 the first event of terrorism we

¹³ See generally *Broader Terrorism Exclusion Options Available in Surplus Lines Market*, INS. DAY, Feb. 14, 2002 (asserting public policy is a concern when evaluating the terrorism exclusion).

¹⁴ See Jay Romano, *Sharp Rise In Insurance On Buildings*, N.Y. TIMES, Aug. 18, 2002, § 11, at 5 (affirming reinsurers are unwilling to provide terrorism coverage to their carriers).

¹⁵ See N.Y. INS. LAW § 1115 (2003); see also MATTHEW BENDER, NEW YORK INSURANCE LAW § 11.09 (2003) (stating no insurer may do business in New York if they expose themselves to a loss exceeding ten percent of their surplus).

¹⁶ See generally E.E. Mazier, *Myths Haunt Insurers After 9/11 Losses*, NAT'L UNDERWRITER, PROP. & CASUALTY/RISK & BENEFITS MGMT. EDITION, Nov. 26, 2001, at 6 (promulgating concerns of surplus decline even before September 11, 2001, increasing the reasons for violating this New York state law).

¹⁷ See generally Judy Greenwald, *Firm Seeks Cover For Invasion Loss*, BUS. INS., June 4, 1990 at 3 (applying war risk exclusion in the business context).

¹⁸ See generally Edward Rothstein, *Shelf Life; Looking for Roots of War and Terror*, N.Y. TIMES, Apr. 5, 2003, at D9 (explaining roots of the "war on terror" in a totalitarian context).

thought we had was when Flight 587 went down quite near here in Belle Harbor, Queens.¹⁹ My little company, Commercial Mutual insured about twelve homes within a ten-block radius of where that plane went down. Those homes are rather expensive homes, if you know the area. If that plane had gone four or five blocks in another direction I would have had a loss of over ten million dollars that would have been uninsured, if the crash turned out to be a terrorism event. Although, Congress and the NAIC have said that we do not need to have TRIA apply to personal lines policies,²⁰ the above is an example where a company would have been out of business had that been terrorism.

Another example under my present reinsurance that would not be covered is if a terrorist used a dirty bomb or some type of nuclear device and blew up an electric transmission plant in upstate New York in the middle of the winter. This event would cause a lot of homes to freeze and damage caused by frozen pipes is covered by our homeowners' policies. That would be a catastrophic loss. There are many, many other examples.

Commercial auto business is covered by TRIA,²¹ and the Robert Plan underwrites about two or three hundred thousand vehicles throughout the country including trucks, and private passenger vehicles. I do not really see a big exposure to terrorism in motor vehicles because motor vehicles move around. They are not in one place at one time. In the World Trade Center there were probably a thousand vehicles destroyed and we insured two of them. There are 140 companies in New York that insure cars. If a bridge is blown up we might insure one or two cars and our exposure is really just the property damage to the two cars. It is not a big exposure and is something very insurable, but commercial auto is included in TRIA.²² I think with the deductibles, we really are not ever going to access or have any coverage provided by TRIA.

¹⁹ See N.R. Kleinfeld, *The Crash of Flight 587: The Overview*, N.Y. TIMES, Nov. 13, 2001, at A1 (reporting the crash and how terrorism was a possible cause).

²⁰ See News Release, NAIC Members Come to Agreement Regarding Terrorism Exclusions for Personal Lines (Jan. 29, 2002) (stating the NAIC's findings that exclusions for terrorism are not necessary for personal lines), at http://www.naic.org/pressroom/releases/rel02/012902_naic_members_agreemnt.htm (last visited Jan. 19, 2004).

²¹ See TRIA §102(12) (codified as amended at 15 U.S.C. § 6701) (stating that commercial property lines are covered).

²² See *id.* § 102(12) (stating that commercial auto lines are covered under the Act).

Insurers are required to send out terrorism disclosure notices to its policyholders.²³ I do not believe we have received any response from any of our policyholders. We sent them a letter saying coverage for acts of terrorism is already included in your current policy. You should know that effective November 26, 2002 on your existing coverage any losses caused by certified acts of terrorism would be partially reimbursed by the United States under a formula established by federal law.²⁴ Under this formula the United States pays ninety percent of covered terrorism losses exceeding the statutorily established deductible paid by the insurance company providing the coverage.²⁵ The portion of your annual premium that is attributable to coverage for acts of terrorism is zero.²⁶ Now, if any one of my customers reads this notice, they will be very confused. It may be nice to know that I am covered for terrorism, but I might be surprised that my premium is zero. I think most companies writing motor vehicle and personal lines have decided on zero premium because that was the easiest way to comply with TRIA.

I have a wish list for the future, because I do not like the idea that I am supposed to prepare myself for all exposures, and my company is at risk for a major terrorism event, and we would be out of business in a major terrorism event because we have no reinsurance for a lot of such events. TRIA does not really have any protection for personal lines. My wish list would be for the Insurance Department in New York to permit primary companies to provide an exclusion for terrorism in our contracts. We should not be put in a position of going out of business, when reinsurers who are excluding terrorism losses are not regulated. However, the alternative would be to require reinsurers to cover terrorism,²⁷ to the extent that, I, a primary company, am required to cover it.

²³ See *id.* § 103(b)(2) (stating that disclosure to policyholders is necessary for insurance companies to be eligible for federal reimbursement).

²⁴ See *id.* § 103(a) (stating that the United States would partially cover any losses caused by certified acts of terrorism).

²⁵ See *id.* § 103(e)(1)(a) (stating that the federal share of reimbursement is 90 percent of the losses exceeding the statutorily made deductible).

²⁶ See generally *id.* § 103(e)(8) (stating the premium policy for the Act).

²⁷ See generally Richard Allyn & Heather McNeff, *Justice In A Changed World: The Fall and Rise of Terrorism Insurance Coverage Since September 11, 2001*, 29 WM. MITCHELL L. REV. 821, 835-837 (2003) (discussing the problems which arose when reinsurers withdrew from the market and increased direct insurers' liability).

A second wish would be that TRIA does get expanded to cover personal lines, which would at least give me some protection. One of the things that I am thinking of doing is forming an insurance pool for terrorism coverage. Perhaps small and medium sized personal lines companies can get together and form a reinsurance pool so at least there will be a sum of money available to support each other in the event one company is hit by a catastrophic terrorism event.

