Does Canada need a terrorism risk insurance scheme?

Introduction

In October 2014 two allegedly Islamic State-inspired Canadians killed two members of the Canadian forces in separate incidents in Saint-Jean-sur-Richelieu, Quebec and Ottawa, Ontario. One of the individuals, an armed assailant, subsequently stormed the Canadian federal Parliament Buildings before being shot dead.

In AON's annual Terrorism and Political Violence Risk Map and related guide for 2015, Canada (and eight other western countries) were rated at 'increased risk'. Nevertheless, Canada's country risk level was rated 'low'. France's country risk level was rated as 'medium' by the same publication. Presumably, the recent horrific attacks in Paris, Mali and elsewhere will have a further effect on the perceived level of terrorism risk in Europe and various other countries, including perhaps Canada. However, it is not yet clear whether there may be a spillover effect on the pricing/availability of terrorism risk insurance in Canada and, if so, whether Canada's need for a government-backed terrorism insurance scheme might be revisited.

History

The genesis of the modern public-private terrorism risk insurance schemes traces back to the events of September 11 2001 in the United States. These attacks cost the insurance industry an estimated US$40 billion, much of which was borne by reinsurers. In the aftermath, many reinsurers subsequently withdrew from providing coverage for terrorism risk. The primary market was generally forced to follow suit and, where permitted, excluded coverage for losses arising from terrorism, since it had no corresponding reinsurance coverage. As a result, many businesses were faced with the prospect of no coverage for future terrorism events. Industries that were potentially vulnerable to 9/11-style terrorist attacks (eg, real estate, construction, energy and transportation) were seriously threatened because investors and lenders required protection for their investments, including insurance that would cover the risk of significant losses, such as those due to a similar terrorist event. In the wake of these events, US Congress stepped in to provide a government-backed terrorism insurance program.

Government schemes

Today, a number of countries have government-mandated or backed insurance schemes for property damage and business interruption occurring as a result of terrorism. After the 9/11 attacks, many of these schemes were either newly created or their form or the scope of coverage was revised.

The US government enacted the Terrorism Risk Insurance Act (TRIA) in 2002. TRIA created a temporary federal program that provided for a system of shared public and private compensation for certain losses occurring as a result of a certified "act of terror". TRIA provides for a government reinsurance backstop in the event of large-scale terrorist attacks. Under TRIA, participating insurers must provide terrorism coverage for the types of insurance included in the statute. The program has been extended a number of times. Most recently, new legislation was enacted in 2015 which amended the expiration date to December 31 2020. Under the program, the federal government will cover each insurer's losses above a certain threshold and the government may levy surcharges to recoup its outlay. Payments by the government under the program have yet to be invoked, despite the Boston Marathon bombing in April 2013.

In France, Gestion de l'assurance et de la Réassurance des Risques Attentats et actes de Terrorisme (GAREAT) was established after 9/11 to cover large-scale property damage and business interruption losses arising out of terrorist attacks occurring on national territory. GAREAT's members are French or foreign insurers that issue policies covering risks situated on French territory. Caisse Centrale de Réassurance, the French state-owned reinsurance company that also covers losses due to natural catastrophes, provides reinsurance coverage (guaranteed by the French government) to GAREAT members.

In the United Kingdom, Pool Reinsurance Company (Pool Re) was formed in the early 1990s to address terrorist acts arising out of events in Northern Ireland. Pool Re was set up as a mutual reinsurer by the insurance industry and the UK government, and its members comprise insurers and Lloyd's syndicates offering commercial property insurance. Members of Pool Re provide cover for terrorism-related losses up to the organization's reserves fund. Following 9/11, Pool Re's cover was extended to 'all risks' (as opposed to only fire or explosion) and various exclusions (eg, biological or nuclear attack) were removed. The UK government provides an indemnity of up to 100% of claims above the value of the fund.

Canadian approach

In Canada, there is no similar public-private terrorism insurance scheme; nor to date has there been any serious groundswell advocating for one. Soon after 9/11, while other countries were putting new terrorism insurance schemes in place or revising existing schemes, the topic was considered by the industry and the Canadian government, but no action was taken.

Although insurers in Canada implemented terrorism exclusions after 9/11, as did their counterparts in the United States, reductions in coverage and escalation of pricing did not cause the same extent of market disruption. This may have been due in part to the fact that primary insurers in Canada continued to cover 'fire following' – potentially a large source of losses following a terrorist attack – in Canadian jurisdictions where regulatory approval was required before an insurer could cease providing the cover, and local reinsurers were willing (although not required by regulation) to provide reinsurance for that coverage. As cited in a *Canadian Underwriter* article in January 2002,[1] the Canadian banking sector did not formally lobby the federal government to provide a scheme affording protection for terrorism risks, apparently because of confidence in its ability to apply risk diversification methods based on the size of the banks' lending and investment portfolios. In fact, a director of the Canadian Banking Association (CBA) indicated that the CBA did not expect that a lack of terrorism risk cover would cause significant disruption to the Canadian lending market, and this appears to have proven to be true.

The Canadian Underwriter later covered a speech made in 2007 by Lord Levene, then chairman of Lloyd's of London, to insurance industry and financial services representatives in Toronto, Ontario.[2] In his speech, Lord Levene suggested that Canada needs a formal, public-private, risk sharing pool to provide businesses with coverage against the risk of terrorist attacks. He noted that Canada is noticeably alone amongst the world's leading western nations in not having a terrorism pool in place.

Nevertheless, a few years later, an article in *Top Broker* in February 2015[3] concluded that to date, neither the marketplace nor the Canadian government has felt the need for a specific terrorism insurance scheme, despite the two events that occurred in Saint Jean-sur-Richelieu, Quebec and Ottawa in October 2014. Nor does it appear that the Canadian banks have developed any plans to lobby the federal government to provide protection against terrorism risk.

At present, terrorism risk coverage is generally available in Canada and a number of large, sophisticated brokerages are actively marketing the product. In addition, certain political risk insurance (including insurance covering terrorism) is available to Canadian businesses through Export Development Canada (the crown corporation that supports and develops Canada's export trade). Whether the availability of this coverage will be affected as terrorism risk escalates in the world remains to be seen. The fact that the recent Paris attacks were perpetrated against 'soft' targets may or may not figure in to the appetite for insurers in Canada to underwrite terrorism risk coverage. If availability of appropriate coverage for a reasonable price is materially affected, there may be renewed interest in a terrorist risk insurance scheme in Canada.

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[1] See www.canadianunderwriter.ca/news/terrorism-exclusions-walking-a-thin-line/1000146569/.

[2] See http://www.canadianunderwriter.ca/news/canada-needs-risk-sharing-pool-to-cover-businesses-after-terrorist-attack-lloyd-s/1000217519/?&er=NA.

[3] See www.citopbroker.com/magazine-archives/upfront-7753.