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GUIDE 2021

Terrorism Risk Insurance

State of the Market

IN ASSOCIATION WITH:

AON
Empower Results®

POOL^{Re} 
REINSURING TERRORISM RISK

Acknowledgements

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.



About Pool Re

Pool Re is the insurance industry's mutual for reinsuring terrorism risk in Great Britain. It was established in partnership with the UK Government in 1993 as a public-private response to the market failure caused by the IRA's bombing campaign against financial targets and city centres during the period. Since then, Pool Re has succeeded in re-establishing a market able to offer comprehensive and affordable terrorism insurance, and paying claims without ever resorting to its Government guarantee.

Pool Re exists to correct market failure, protect the UK economy, and safeguard society and livelihoods from acts of terrorism. We offer a financial safety net for around £2.2 trillion of assets and businesses of all sizes, from shopping centres and local traders to airports and power grids, across sectors of the economy such as real estate, retail, transport, construction and energy. Today, we are recognised as a global leader in the sector, uniting the public and private sectors to scale the UK's resilience to terrorism.



About Airmic

The leading UK association for everyone who has a responsibility for risk management and insurance for their organisation, Airmic has over 450 corporate members and more than 1,300 individual members.

Individual members include company secretaries, finance directors, internal auditors, as well as risk and insurance professionals from all sectors.

Airmic supports members through training and research; sharing information; a diverse programme of events; encouraging good practice; and lobbying on subjects that directly affect our members.

Above all, we provide a platform for professionals to stay in touch, to communicate with each other and to share ideas and information.

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01 Introduction

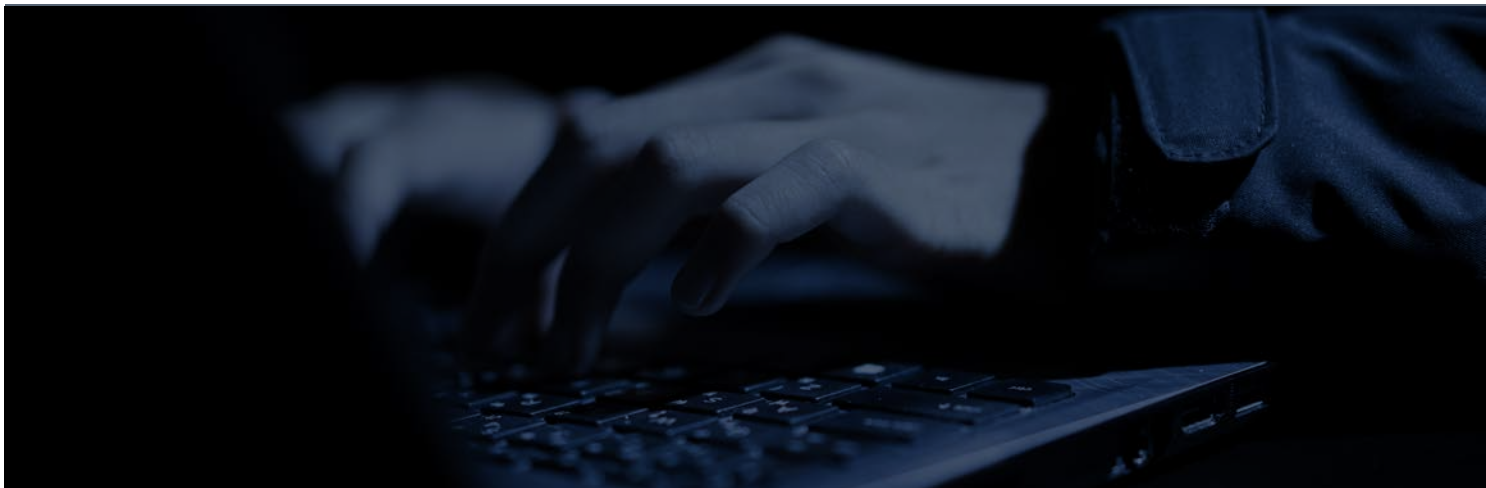
As Aon's Risk Maps 2020 report on political risk, terrorism and political violence highlighted,¹ in the number of terrorist attacks in Western countries by Islamist extremists has continued to drop year-on-year, as the terrorist group Islamic State has become more preoccupied with operations by its affiliates in the Middle East, Africa, and Asia.

Meanwhile, extreme right-wing terrorist attacks have increased in frequency over the past five years. Lone actors have been the primary perpetrators of attacks motivated by right-wing extremist ideas, often emulating one another.

The Covid-19 pandemic offers new opportunities for terrorist groups, which have taken advantage of the situation of flux wreaked by the pandemic to resuscitate their movements. The pandemic may seem

to have had a suppressive effect on terrorist groups and their ability to operate – at least initially, until the terrorist incidents in France and Austria in 2020 – but it has also challenged the ability of counter-terrorism forces to keep terrorist threats in check.

The threat of terrorism is constantly evolving. Terrorist attacks, now regarded as a foreseeable risk, can result in human casualties, property damage, business interruption, legal liability issues and long-term damage to brands and reputations. Organisations also need to ensure corporate governance and duty of care responsibilities are integral to their crisis management strategy.



02 What do you need?

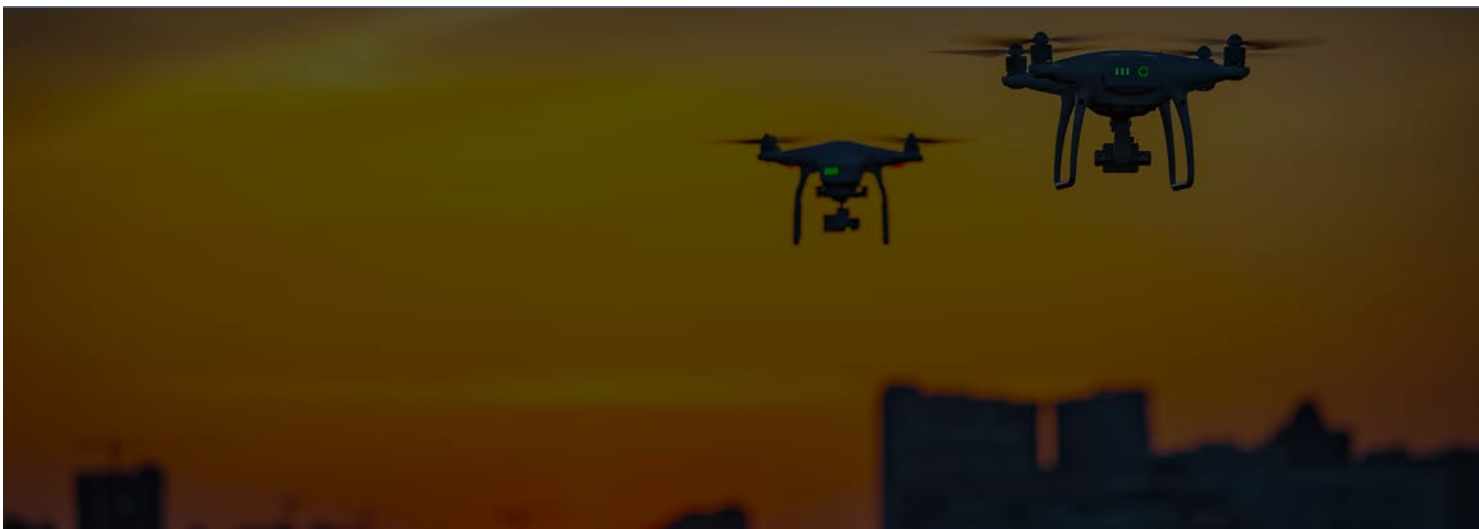
What should you be concerned about?

Traditionally, the market and buyers have looked at property damage as their main vulnerability to a terrorist event. However, terrorism is evolving, and the targeting and delivery of attacks is changing. Drones, vehicles, chemical agents are now very much part of the potential attack landscape, with a much wider spectrum of potential impacts on people and businesses.

Risk management is no longer focused on providing financial resilience against the loss from a potential bomb in a car or a package. The current terror risk landscape shows an increased frequency of smaller attacks. While these have not brought about the same loss to physical assets such as buildings, they can deliver devastating long-term economic impacts. It is important that insurance buyers and risk professionals understand not only what the potential impacts

are from the evolving nature of terrorism and how their businesses can be affected, but also what they can do to protect them.

While the terrorism peril has moved towards reduced severity/higher frequency events, the potential remains for a significant property loss event. Businesses still need to be protected from the large events delivering the damage equivalent to the bombings of Bishopsgate in 1993 and of the Baltic Exchange on St Mary Axe in 1992. Pool Re – as will be further discussed below – remains one of the most efficient vehicles to deliver property damage and business interruption coverage, physical damage resulting from a cyber-terrorism trigger, and full value chemical, biological, radiological and nuclear (CBRN) coverage. However, how can companies complement Pool Re's comprehensive property damage coverage?



02 What do you need?

How to define the event

With the recent shift from large physical loss to the smaller-scale losses associated with mass casualty attacks, companies, their employees and visitors can still be exposed to losses. These attacks were orchestrated by one or a few people, unlike the large co-ordinated attacks seen, for example, in the 2001 attack on the World Trade Center or the 2007 London bombings, challenging the definitions currently used in parts of the insurance industry.

It is important to recognise the scope of the definition of terrorism on a policy. The 1993 Terrorism Act definition, initially used by Pool Re, does not explicitly provide coverage for single actors, although the Westminster Bridge attack involving a lone actor was certified, and refers to those directly connected to a terrorist group. The 2000 Terrorism Act broadens the trigger to include single actors, in addition to groups, and explicitly refers to the

motivation being ideological, although this would also be capable of inclusion in the 1993 Act. Pool Re members use the 1993 definition within their terrorism exclusions in property coverage, so the Pool Re terrorism cover is therefore back to back.

Currently, the market offers products triggering on events where the attackers are not connected to a religious group. Further, the market can extend elements of coverage to include malicious acts –where the motivation of the attacker is not necessary to be known – thereby providing the broadest coverage possible, not subject to interpretations or differences in the various terrorism acts or requiring certification as terrorism by the UK government. Following the 2017 London Bridge attack, it took 30 days for the event to be labelled a terrorist event, exacerbating the impacts felt by local businesses.

What else can you be exposed to?

Non-Damage Business Interruption: with the rise of mass casualty attacks making use of low-technology weapons, the potential for no resultant property damage has increased (the traditional trigger for a terrorism policy). After the 2017 London Bridge attack, there was very little physical damage. Instead, there were large indirect business interruption losses for small businesses, particularly for those surrounding the area. The economic losses are estimated at around £1.4 million, borne mostly by smaller and medium-sized businesses. Some local businesses' claims were declined as policies only covered physical damage-related business interruption, if at all. Other non-damage events illustrate potential gaps in coverage. Anecdotally, the non-damage BI losses from the 2017 Oxford Street 'terrorism threat' event were higher than those from the London Bridge attack, occurring as they did on the busiest shopping day of the year.

In contrast, the Manchester Arena attack is estimated to have resulted in a £3.5 billion loss in UK economic output. Nineteen businesses were impacted by the inner cordon, though not necessarily experiencing direct property damage themselves.

All businesses large and small were impacted by the cordons that were put in place after the attacks. Understanding the police response and subsequent forensic investigation is a fundamental part of understanding the potential scope of loss from an attack, whether explosive, kinetic vehicle or bladed weapon, or as with Salisbury, a chemical contamination event.

03 Wider impacts

The attack, the response and the anxiety

The Salisbury Novichok attack illustrates how a micro chemical attack can drive discussion on macro CBRN coverage gaps, presenting an opportunity to develop bespoke products for future incidents.

- The decontamination efforts, along with the prolonged period of denial of access/business interruption prompted the need for more inclusive cover.
- Not dissimilar to the challenges surrounding both the London Bridge and the Manchester Arena attack, in Salisbury, police cordons caused business interruption and loss of attraction.
- Many small privately owned businesses remained closed throughout the investigation and during the following months.
- The time it took to declare a major incident may also have hindered first responders and increased exposure to the nerve agent.
- 74 local businesses were given 'revenue grants', 30 were given 'capital grants' via the Swindon and Wiltshire Local Enterprise Partnership, and business rate relief was provided to 56 business – in all, totalling circa £700,000.
- The investigation spread over 27 miles and two counties.
- Multiple locations were cordoned off and there was a 40%-50% decrease in footfall.
- Businesses within the cordon experienced 100% revenue losses.
- Businesses nearby to the affected area experienced 60%-70% loss of revenue.

- CBRN was invariably excluded by all commercial insurance policies.

Building more responsive solutions

We can look at the various terrorist events that have occurred, in order to examine how businesses can be impacted by different types of events and define what type of coverages might be needed, beyond traditional property damage and resultant business interruption.

More generally, we can divide the impacts into short term and long term.

Short term:

- Damaged goods, destroyed property, damaged infrastructure
- Businesses experience reduced trading due to police cordon/investigation making areas out of bounds, transport disruption restricting access, as well as a change in consumer sentiment as a result of the attack, all resulting in reduced short-term commerce in the days, weeks and months after an attack.
- Significantly, small businesses lack the financial resources, operational capacity and redundancy to deal with these unexpected shocks.

Other examples:

Long term:

Attack	Estimated short-term economic impact
Brussels, 2015	<ul style="list-style-type: none"> • €1bn loss in Belgium's GDP²
Paris, 2015 and 2016	<ul style="list-style-type: none"> • €750m loss in tourism revenue in Paris region³
London bombings, 2005	<ul style="list-style-type: none"> • West End footfall down between 20%-30%⁴ • 9 months for the demand for hotels in London to recover after the attacks⁵ • A reduction in annual tourism revenues of around £750 million⁶
New York, 2001	<ul style="list-style-type: none"> • 145,000 jobs lost⁷ • \$80 billion to \$90 billion of lost economic growth⁸

- These short-term impacts compound into longer-term effects on economic growth.
 - Transaction cost and delays in economic activity may increase as a result of heightened security measures.
 - Opportunity costs – planned investments by businesses may not be undertaken due to short-term shock on revenue or due to other costs incurred as a result (for example, expenditure on security). Thus, preferred consumption is foregone. On a macro level, foreign direct investment may be limited
 - Shift in consumer demand due to a change in consumer sentiment, which often continues into the long term
 - A number of studies have estimated the long-term economic impacts on selected locations.
- These include:

Attack	Estimated long-term economic impact
Northern Ireland	<ul style="list-style-type: none"> • If economic activity in Northern Ireland had matched the UK average:⁹ • GVA per capita would have been £5,845 higher • 60,000 more jobs would have been created • There would have been £274 million more tourist spend • There would have been 3,745 more business births
Basque Country (Spain)	<ul style="list-style-type: none"> • Between 1976 and 1996, GDP per head was 10% lower than it would have been had there been no terrorism⁹
Spain	<ul style="list-style-type: none"> • Over 22 years of terrorism, Spain lost a full year's worth of tourism revenues⁹ • Terrorism reduced levels of FDI by 13.5%¹⁰

03 Wider impacts

The victim

Lastly, an important area to consider is the impact of an attack on the victims. People are the cornerstone of any business and, in recent events, we have seen employees and visitors or guests on a property injured or killed during attacks. Do organisations have coverage around victim's compensation that can step in for immediate financial relief? There are various compensation schemes in existence; however, the time lag of payment places additional financial stress on families, beyond the event ramifications themselves. Many carriers now look

to offer compensation for employers to assist their employees immediately after the event, and to help them get back to normalcy and to work as quickly as possible. And while there are insurance vehicles available to allow insureds to provide swift financial support for all those injured or killed on their properties, they are not universally taken up.

The market in terrorism is dynamic and responsive. It is evolving to meet the changing impacts of terrorism events to ensure that the right coverage is available to respond to the evolving peril.

Terrorism risk insurance: types of coverage

	Carrier 1 - Global	Carrier 2 - Global	Carrier 3 - Syndicate	Carrier 4 - Syndicate	Carrier 5 - Facility
CAPACITY ALL LINES	<p>USD 100m NML basis</p> <p>USD 200m on a 200m blast zone basis, Nuclear, Biological, Chemical and Radiological</p>	<p>USD 200m NML basis</p> <p>Chemical, Biological, Radiological & Nuclear (CBRN) & CBRN Liability</p>	<p>USD 25m NML basis</p> <p>USD 75m / USD 100m on a 250m blast zone basis, Nuclear, Biological, Chemical and Radiological</p>	<p>USD 25m NML basis</p> <p>USD 45m on a 200m blast zone basis</p>	<p>GBP 300m PML basis</p>
LINE OF BUSINESS APPETITE	<ul style="list-style-type: none"> Property damage/ Business Interruption from: Terrorism Strikes, Riots, Civil Commotion Political Violence (including war) Event Cancellation Aviation War / Aviation Third Party Terrorism Political Risk Employee & General Liability resulting from Terrorism 	<ul style="list-style-type: none"> Property damage/ Business Interruption from: Terrorism Strikes, Riots, Civil Commotion Political Violence (including war) Active Assailant Employee & General Liability resulting from Terrorism 	<ul style="list-style-type: none"> Property damage/ Business Interruption from: Terrorism Contingency Terror Business Terror Liability 	<ul style="list-style-type: none"> Property damage/ Business Interruption from: Terrorism Strikes, Riots, Civil Commotion Political Violence (including war) 	<ul style="list-style-type: none"> Property damage/ Business Interruption from: Terrorism Political Violence Non-damage BI (Threat & Act) Terrorism Malicious Cyber terror (Property damage resulting) Employee & General Liability resulting from Terrorism
INSUREDS	<ul style="list-style-type: none"> Airlines Banks Exhibitions Industrial Classes Infrastructure Leisure Complexes Manufacturers Military Mining Motor Industry Museums Oil and Gas Companies 	<ul style="list-style-type: none"> Offices Pharmaceuticals Ports Railroads Residential Restaurants Retailers Schools Telecommunications Transport Utilities/Power Warehouse/ Storage 	<ul style="list-style-type: none"> Fortune 500 Real estate Offices and banks Power and utilities Chemical and pharmaceutical Energy - oil and gas Construction and mining Hospitality Transport 	<ul style="list-style-type: none"> Fortune 500/1000 style companies Industrial Risks Commercial Risks 	<ul style="list-style-type: none"> Airlines Banks Exhibitions Infrastructure Leisure Complexes Manufacturers Motor Industry Museums
DISTRIBUTION	<ul style="list-style-type: none"> Global offices Global broking houses 	<ul style="list-style-type: none"> Global offices Global broking houses 	<ul style="list-style-type: none"> Distribution via Lloyd's/ Brokers Facility/Consortium Participation 	<ul style="list-style-type: none"> Distribution via Lloyd's/ Brokers Facility / Consortium Participation 	<ul style="list-style-type: none"> Global and Aon UK Offices

04 The role of Pool Re

Pool Re is the insurance industry's mutual for reinsuring terrorism risk in Great Britain. It was established in 1993 in response to an insurance market failure triggered by the terrorist bombing of London's Baltic Exchange. The actual and prospective costs of the Provisional IRA's mainland bombing campaign in the 1990s led international reinsurers to withdraw cover for terrorism-related damage, which compelled insurers to follow suit. The collapse would have left businesses unable to obtain commercial cover for terror events, and confidence in the City of London and major commercial centres was at risk.

In response, the insurance industry founded Pool Re in co-operation with HM Treasury, to create a private-sector solution in support of a public policy objective. The scheme is owned by its members, comprising the vast majority of insurers, Lloyd's Syndicates and captives that offer terrorism insurance for commercial property in Great Britain. Pool Re covers over £2 trillion of assets

and is underpinned by an uncapped HM Treasury loan facility to support the scheme if it ever has insufficient funds to pay a legitimate claim. This facility, however, has never been called upon, with Pool Re paying £1.25 billion when adjusted for inflation in respect of 17 claims arising from events certified under the 1993 Reinsurance (Acts of Terrorism) Act.

Pool Re's activities are funded by premiums received from its members. Profit is not the mutual's objective; rather, surplus has been prudently invested to build a multi-layered resilience structure and, since 2015, to pay a dividend to members and HM Treasury. Since 1993, the scheme has succeeded in its dual aim of both fulfilling its public policy objective of increasing the resilience of the UK economy to acts of terrorism and re-establishing a commercial market able to offer comprehensive and affordable terrorism insurance.

How does the scheme work for captives?

Captive membership of Pool Re works in the same way as that of any other authorised insurer, regardless of domicile, with guaranteed acceptance of all eligible terrorism exposure in Great Britain regardless of size or location. There is no charge for membership, though there is the chance of receiving an annual dividend return. Reinsurance premiums are calculated as a percentage of the sum insured in accordance with the postcode of the risk, with every postcode assigned one of four tiers. In turn, the captive and policyholder must reinsure their entire portfolio to the pool. Central to the proposition is the integration of Pool Re's cover with the underlying property policy, which ensures that there is no gap in the cover provided.

The scheme provides comprehensive cover for damage to commercial property and associated business interruption arising from an Act of Terrorism (as defined by the 1993 Act). Most types of commercial property are covered: buildings, their contents, site property, construction projects, and plant and machinery. Cover does not extend to private property, but it does extend to residential property owned by a business.

An important element of the reinsurance cover provided by Pool Re is its unlimited nature. This is especially important for many captives fronting large exposures, which can be reinsured directly to Pool Re to the full extent of the underlying exposure.

Combined with the certainty of risk acceptance and of any claim regardless of size being met in full by virtue of Pool Re's unlimited HM Treasury loan facility, the scheme's wide cover is complemented by discounts available for certain exposure types and programme limits. As an example, a large infrastructure risk received a discount of 30% on its terrorism premium due to the loss limit that would apply to any claim. Further, Pool Re incentivises effective risk management through participation in NaCTSO's Crowded Places programme and through its own police-approved Vulnerability Self-Assessment Tool (VSAT), each of which can result in 7.5% premium discount.

Which classes are covered?

Pool Re's proposition has evolved with the changing nature, priorities and methodologies of terrorism.

Only 'Fire and Explosion' were necessary in the case of the IRA's bombing campaign, but following 9/11, the scheme incorporated chemical, biological, radiological and nuclear (CBRN) into its cover. In March 2019, following the spate of attacks in the UK in 2017, it made non-damage denial of access and loss of attraction not contingent on property damage (NDBI) available to its members. This class

is optional and is not directly related to cover for damage. In fact, Pool Re has not only kept pace with the threat, but in some cases, has pre-empted it, future-proofing its proposition in 2018 against materially destructive cyber terrorism, the first global pool to do so. Included as standard, this cover is limited to specific perils, and excludes data and money theft. Excluded classes are marine, aviation or transit policies, motor policies, reinsurance business, general liability life or personal injury insurance.

05 Public-private progress

Over the past 27 years, Pool Re has become a leading authority on understanding, financing and mitigating terrorism risk in Great Britain.

As the world economy struggles to produce consistently strong growth, and with rising pressure on governments to increase public spending on welfare and services, the re/insurance industry has been stepping forward to provide solutions to alleviate the costs of the insurance protection gap within the global economy. In recent years, Pool Re has pursued a strategy emphasising the sustainable transfer of risk from the public to the private sector. The greater involvement of the private sector is crucial for growing capacity and for developing a healthy, competitive, innovative terrorism market that is able to meet the needs of policyholders and respond to a dynamic risk as it evolves.

With the pool acting as an incubator, carriers are shielded from the uninsurable tail of the peril, but are stimulated with the tools and incentives for them to benefit from assuming a growing portion of attritional terrorism liabilities. The pool reinsures the large majority of carriers that offer terrorism insurance for commercial property in Great Britain.

In the last five years in particular, however, Pool Re has accelerated its strategy of providing the commercial market with the information, tools and incentives necessary for it to understand and retain terrorism risk to a greater extent. From the scheme's perspective, the more policies the industry sells, the better the resilience of the national economy to terrorism, and the more insurers are able to grow premium opportunities and invest in innovation.

Milestones for the pool since 2015 have included bridging protection gaps such as cyber and NDBI; placing the first terrorism insurance linked securities (ILS) transaction; agreeing to finance a unique information exchange platform to allow insurers to benefit from the expertise of the UK's world class counter-terrorism agencies; and, in November 2019, unveiling Pool Re Solutions, an offering to members comprising market-leading risk awareness, modelling and management products, which captives such as Heathrow Airport have already benefitted from. Airmic members are encouraged to contact Pool Re Solutions to see how they might benefit from the expertise of this new terrorism risk management division.

Pool Re, by numbers

£2.2tn

of liabilities insured by Pool Re.



Terrorism insurance
Large and small business



£278m

paid to Members as dividends between 2015 and 2019.



Insurers

150+ members

the vast majority of insurers operating in the UK commercial property market are Members of Pool Re.

£1.25bn

over the past 27 years Pool Re has paid claims in excess of £1.25bn across 17 terrorism events (adjusted for inflation).

£2.325bn

of commercial retrocession purchased by Pool Re from private sector reinsurers.



£6.37bn

fund has been built up by Pool Re to meet potential claims.



Pool Re

£75m

raised from external investors through the placement of an insurance linked security bond.



£1.19bn

of premiums have been paid to HMT Treasury, though Pool Re can draw on this amount should Government funds be required.



Government guarantee

£0

cost to the taxpayer.

06 References

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Marlow House
1a Lloyd's Avenue
London
EC3N 3AA

Tel: +44 207 680 3088
Fax: +44 207 702 3752
Email: enquiries@airmic.com
Web: www.airmic.com