

# Terrorism risk (re) insurance: Minding the Gap

Terrorism methods and objectives have evolved. Insuring for this risk should also adapt to such changing circumstances. Given fresh challenges, and to share experiences among the various different systems of cover and examine alternatives, the International Forum for Terrorism Risk (Re)Insurance Pools (IFTRIP) has come into being. This article describes the circumstances and process behind the creation of IFTRIP from the standpoint of the experience of Pool Re, which is the British pool for terrorism risk insurance.

**Julian Enoizi**

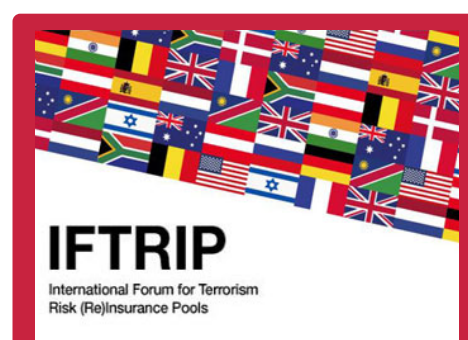
Chief Executive Officer  
Pool Re, Ltd.

Terrorism has become an international phenomenon which knows no borders. Attacks are occurring across the globe with alarming frequency. Terrorist's methods and capabilities are more diverse and increasingly difficult to mitigate against. Their motivations are more sinister. Causing loss of life rather than economic damage is the principal aim of today's fanatics. Tragic events have provided the catalyst for the creation of IFTRIP, the International Forum of Terrorism Risk (Re)Insurance Pools.

IFTRIP was formally created at the Second Annual Global Terrorism Risk Insurance Congress, hosted by the Australian Reinsurance Pool Corporation (ARPC) in Canberra in October 2016. It was a defining moment for international collaboration between national terrorism pools, and represents the culmination of nearly two years' work by the Pool Re team and colleagues from pools across the world. At time of writing, IFTRIP has 13 members. At its core, IFTRIP is about collaboration between these national organisations. It is about the pooling of experience and expertise. It offers the potential to alter how the world's insurance industry protects against and responds to acts of terrorism across the globe.

The case for such an organisation has never been clearer. The terrorism landscape has evolved. The nature of targets has changed, digital threats have moved squarely into the frame, and motivations have shifted from nationalist to fundamentalist. The insurance market's appetite for terrorism risk has also evolved, but pools remain necessary to provide reinsurance for the risks – such as Chemical, Nuclear, Biological, and Radiological (CNBR) risks, and cyber terrorism – that the private market cannot or will not insure. Their lack of appetite for these risks leaves a Terrorism Insurance Gap, which is now larger than ever. As the terrorists' methods evolve, the Gap continues to increase.

IFTRIP's overarching aim is to contribute to the creation of a more robust international response to the grave and evolving threat posed by the Terrorism Insurance Gap. The need for IFTRIP in part reflects the way terrorism has evolved. The threat posed by domestic terrorism and the IRA's bombing campaign against the British mainland



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prompted the establishment of Pool Re in 1993. Its foundation was mirrored in many other countries which experienced both domestic terrorism and the inability of private (re)insurers to provide the requisite cover. However, terrorism is now an international phenomenon. IFTRIP is an international response.

The most recent report from Pool Re's Terrorism Research and Analysis Centre highlights the issue of the Terrorism Insurance Gap. Enormous terrorism risks to property remain uninsured. This coverage gap is exacerbated by a significant knowledge gap regarding the nature of terrorism risk, both at the level of individual businesses, and within the insurance industry. Pool Re, through a range of measures including its research, is providing the international risk market with the information and expertise to make sure businesses are aware, and can respond effectively to the threat of terrorism.

A number of emerging themes are likely to dominate the security landscape in 2017, the research found. Despite the probable military defeat of Daesh (also known as Islamic State) in Iraq and Syria, the ideology of the group is likely to endure. Security experts expect that Daesh will mutate and evolve into a more dangerous and diffuse entity. The so-called Caliphate will become more 'virtual' than physical, with the group increasing its activity online as its physical security is threatened and its seized territory recovered. It is thus expected that Daesh will move into 'ungoverned spaces' – be they geographical areas or the Dark Web. It is likely that its focus will turn to the most motivated and hard-line followers of Daesh, and inspire or direct these individuals to cause mass casualties and economic damage.

Perhaps the biggest challenge rests with security agencies and governments, which must determine how to deal effectively with the high number of experienced foreign fighters returning to their home countries. This 'reverse flow' phenomenon raises difficult questions for liberal democracies. How they should manage, de-radicalise, and reintegrate those who are sitting outside the criminal justice system? A final theme for 2017 is the possible reassertion of Al Qaeda (AQ) as the dominant global terrorist group, with the capability, experience, and technology to match. A worst-case scenario would see the alignment of Daesh and AQ.

Despite the political upheavals of 2016, governments around the world continue to improve collaboration and information exchange on terrorist activities. Both the 2015 UK National Security Strategy and the Strategic Defence and Security Review (SDSR) recognised the threats posed by radical extremism, and have directed significant resources into counter-terrorism measures. The UK government's counter-terrorism strategy, CONTEST, is being refreshed. The business community expects improved public/private sector partnerships. A key strand of this is the provision of appropriate and timely information on the nature of the contemporary threat to businesses, their people, and their assets. Closing the terrorism information gap will remain high on the private sector's list of priorities during 2017, and is one of IFTRIP's roles.

Pool Re and other terrorism reinsurance organisations recognise that interaction and collaboration between the state and the private sector is fundamental to successful terrorism risk management and the long-term resilience of economies, given the new international, cross-border nature of terrorist acts. This was demonstrated at the second Annual Congress, where much of the discussion focused on emerging counterterrorism strategies.

Another topic was the need for terrorism pools and the global (re)insurance market to innovate and provide appropriate and affordable terrorism cover to mitigate losses arising from the changing nature of the terrorist



IFTRIP members representatives at the Second Annual Global Terrorism Risk Insurance Congress, Canberra (Australia), October 2016.

threat. Terrorism insurance is more complex than most other classes of business. However, if the market innovates and applies all the extensive resources of the industry, including deploying the excess capital in the market, IFTRIP and its members could lead in the provision of gold-standard terrorism insurance products by extending coverage to newly recognised risks such as denial of service and non-damage business interruption.

I am delighted that IFTRIP has been able to develop a shared vision of the role that reinsurance pools can play in better protecting our nations' economies. The group symbolises a new departure that offers the potential to alter how the insurance industry protects against and responds to acts of terrorism around the world. ARPC, hosts of the second Congress, surpassed themselves in terms of presentations and debates relating to topics including CNBR, cyber terrorism, radicalisation, modelling, and the Terrorism Insurance Gap. The benefits of sharing views around the evolving nature of the threat has proved invaluable in informing debate, ensuring our joint and individual continued relevance to our various stakeholders, and building resilience within our domestic infrastructures.

IFTRIP will address a number of key issues. Chief among them is how to deploy our collective expertise and experience to close the Terrorism Insurance Gap. We will also consider whether IFTRIP could facilitate collaboration on an international Insurance-Linked Securities (ILS) placement for terrorism risk. The prospect of crafting and issuing a terrorism bond is of particular interest to Pool Re, but we as an industry need not stop there. Through collaboration under a new legislative framework for ILS in the UK, IFTRIP may be able to design new kinds of coverage which create opportunities for the insurance market, while removing liability from the governments' balance sheets, and thus from taxpayers.

Analysis of terrorism risks has evolved dramatically, and now permits better risk assessment and modelling, and even greater private-sector participation in terrorism risk transfer. This analytical know-how, alongside collaboration between state and market, has allowed both to be appropriately remunerated for the terrorism risks they are running. ILS should be embraced as a logical next step, and will be facilitated by the newly developed and developing analytical tools and technologies.

When Pool Re was formed, terrorism risks were widely considered uninsurable. However, the private insurance market has gradually entered the class by dint of retentions and retrocession. We have showed that commercial reinsurers have a notable appetite for terrorism risk. Our cessions to them underpin our role as a facilitator of markets until such time as the private sector can take them over completely. In the meantime, however, we face the fact that commercial appetite for terrorism risk is limited. It is non-existent for some branches of the risk. The Terrorism Insurance Gap is huge. An ILS terrorism bond may be the appropriate tool to draw in new risk capital to supplement the available private reinsurance, and further remove taxpayers from potential losses.

In a globalised economy, British companies and those of our allies have international exposures, and Britain has always been a global leader in the fight against international terrorism. The London insurance market is also a global leader, and possesses a depth of knowledge in the insurance of both terrorism and political violence that sets it apart from other risk trading centres. It is not only the historic relationships built around Lloyd's and London Market (re)insurers, but also the network of legal, actuarial, technological, and financial experts that make London a global centre. All this could be mobilised to benefit those nations fighting terrorism around the world through the construction of an ILS bridge over the Terrorism Insurance Gap.

By offering our insurance expertise, IFTRIP and its members will help businesses trade more easily in areas considered at risk, thereby promoting stability. Reawakening or cultivating insurance markets in countries where the threat of terrorism or political violence is considered to be high will go a long way to ensuring that those economies are able to rebound from major incidents, protecting what are often nascent or fragile democracies. The UK is already a world leader in the development of innovative reinsurance structures that allow insurers to underwrite business that would

otherwise be too risky. This expertise can be further developed. The creation of a dedicated international terrorism reinsurance vehicle could provide the confidence to underpin a market's development, whilst allowing London (re)insurers to build new revenue streams, and to close the Terrorism Insurance Gap.

The Third Annual Global Terrorism Risk Insurance Congress will be hosted by GAREAT in Paris this summer. In advance, we will continue to work tirelessly with our international colleagues, including our good friends at the CONSORCIO, to build a more united international terrorism insurance market. We will look to forge closer ties with the commercial risk market, and to dispel any notion that the goals of international pools and private carriers are incompatible. In doing so, we can close the gap between what we can and cannot cover, and develop a more concerted response to this grave international threat.