

UK NUCLEAR TERRORISM INSURANCE ARRANGEMENTS: AN OVERVIEW

Mark G Tetley

Nuclear Risk Insurers Ltd

Minster House, 42 Mincing Lane, London EC3R 7AE, U.K.

mark.tetley@nuclear-risk.com

ABSTRACT

The risk of terrorism in the UK is not new, but since the New York World Trade Centre attacks in 2001, the potential scale of any terrorist attack has required a considerable reassessment. With UK foreign policy closely aligned to that of the USA, the UK security services now consider it is simply a matter of “when” and no longer “if” the UK is attacked. For insurers of any type this fact would cause concern; for insurers involved in high profile and potentially catastrophic loss targets such as nuclear power plants, any attack could have a severe impact on solvency and shareholder’s funds.

This paper’s objective is to describe the terrorism insurance arrangements put in place in the U.K. both before and after the September 2001 attacks. These arrangements have been designed both to safeguard insurers’ solvency and to ensure that the nuclear industry and general public can continue to be reassured by the availability of insurance should an attack ever occur.

1 INTRODUCTION

In today’s world, terrorism is everywhere; we read about it in the newspapers, we see images on television, we listen to horrific accounts from far away countries in the world, and some of us have to suffer the disruption caused by terrorism threats and actions. Almost anyone in the world today can conjure up their own image of what terrorism means to them, whether it is the collapsing towers of the World Trade Center or those hideously deformed trains blown apart in Madrid recently. With all the existing focus on terrorism it is easy to forget this is not a new threat and indeed terrorism has been with us for many many years.

In this paper I will focus on the UK, a country that has suffered various forms of terrorism for at least 50 years; and I will describe the insurance arrangements that were put into place long before the World Trade Center attacks occurred. I will describe the mechanics of Pool Re and the arrangements for the nuclear industry. Also specifically the changes made to the terrorism arrangements after the World Trade Center attacks and other more recent developments relating to the third party liability regime implemented with the Government and I shall end with some other current concerns and ideas on how we might meet the challenges ahead.

2 HISTORY

So let me start with a brief history of terrorism in the UK. In the 1930’s London suffered several explosions as a result of bombs placed in strategic places in the capital by Irish nationalist terrorists. Perceived injustices in the north of Ireland exploded into direct action after the independence of the south from the United Kingdom in 1916. Even before that, the British political establishment had learnt that terrorism was often an effective and deadly way of achieving significant disruption during many a military campaign in far flung parts of the British Empire. In particular the Boer campaign against the British Army in South Africa at the beginning of the 20th Century showed a very effective use of terrorism.

In the UK modern terrorism re-commenced in 1974 in a series of horrific bomb blasts all over the UK, designed solely to kill, injure and disrupt the lives of ordinary people. The Irish Nationalist campaign, taken to the British mainland so effectively, escalated in the subsequent 20 years and in 1992, the terrorists achieved the most spectacular success in economic terms by detonating a large bomb in London. The

increasing magnitude of these attacks had not only significant social consequences but also economic ones. Hitherto the economic consequences had been borne and managed by the insurance industry in the UK, but this bomb that exploded in the heart of the financial district of London (just opposite the Lloyd's building) caused extensive damage to many buildings and almost destroyed the Baltic Exchange; the final cost of all the damage and business interruption was over £450m (\$785m). This event served as a wake-up call to the Insurers who realised that a relatively simple device could have enormous disruptive capability and could, in reality, threaten the solvency of some Insurers.

3 INSURERS INITIAL RESPONSE TO “MASS” TERRORISM RISK

Therefore, following this bomb, members of the London Insurance market initiated discussions with the market Associations and with Government to try and establish a means of restricting Insurers' and Reinsurers' exposure to major terrorist events. In 1993 these discussions culminated with the formation of Pool Re; in simple terms Pool Re offered unlimited Government-backed reinsurance funds for Insurers who suffered a loss caused by fire and explosion as a direct result of terrorism. Pool Re left the insurance market with a very low retention but a key aspect of the newly established Pool Re was that there was no cover provided for the nuclear installations. However, all other commercial property was covered under Pool Re but for Fire and Explosion Terrorism losses only, although at the time this was not thought to be a significant detail. Pool Re required that all administration and premium collection was to be undertaken by the insurance market and any insurer underwriting risks in the UK who was regulated either as a UK company or a foreign one could participate.

The establishment of Pool Re proved to be very timely as the year following, another huge blast rocked the financial centre of London. Terrorists had realised that by striking at the economic heart of the UK, they could achieve far greater attention for themselves and achieve political concessions. Significantly, despite the size of these enormous bombs, the total death toll was only 2 from both explosions. The IRA campaign in the UK continued with several more devastating bomb blast. A London bomb in Aldwych in 1996 was caused by the bomber accidentally letting off the bomb himself while he was carrying it on a bus. He died. In 1996 two further devastating bombs occurred, one in Manchester and one more in London. It became apparent that this latest campaign of terrorism was much more serious than anything seen previously and the lack of terrorism cover for the nuclear facilities in the UK began to cause concern. Therefore in 1995, Pool Re (Nuclear) was formed.

Pool Re (Nuclear) covered all insurers who participated in nuclear insurance in exactly the same way as Pool Re, that is to say Fire and Explosion coverage only on nuclear installations with Insurers still being responsible for the administration and collection of premium; the Government acts as a reinsurer of last resort. However, it should be noted that the threat of terrorism had not suddenly been noticed by the nuclear industry, in fact security arrangements for nuclear installations had been thought about from a very early stage of the nuclear programme development in the UK.

4 NUCLEAR SECURITY MEASURES IN THE U.K.

In 1955 a unique Police force was established under the control of the United Kingdom Atomic Energy Authority which was given jurisdiction and control over all the nuclear sites. It was established as a specialist anti-terrorism Police Force and, uniquely in the UK at the time, had armed policemen. From the moment the Force was established it was given very extensive powers that remain today: it has nominal control of a three mile radius around each nuclear site, it is responsible for security of all nuclear material in transit in the UK and Officers of the Force have complete control over any pursuit of stolen nuclear material anywhere in the UK.

So nuclear security had not been ignored and by 1995 was augmented by insurance arrangements that relieved insurers of the worst foreseeable terrorist attack with the Government as reinsurer of last resort. In the late 1990's, the Irish Nationalist campaign of terrorism in the UK actually waned as the Government and the IRA moved towards negotiation, no doubt in some ways stimulated by the terrorist atrocities of the previous years.

5 NEW TERRORIST THREATS TO INSURERS' SOLVENCY AND THE THIRD PARTY LIABILITY ARRANGEMENTS

On September 11th 2001 our perceived notion of what constituted a terrorism attack was changed dramatically. Suddenly the West was faced with highly organised and motivated religious fanatics who cared nothing about the human cost of an attack. These people proved that a co-ordinated attack on a high profile target was now something that gave the attacker immense profile and often favourable attention around the world and, once again, with the news that perhaps one of those planes flying on September 11th was destined for a Nuclear Power Station, the nuclear industry came in for some scrutiny. But it wasn't just nuclear that was affected by the World Trade Centre attacks. The enormous insurance costs across many classes of insurance showed that terrorism now posed a real threat to all insurers' solvency and a further hasty review was instigated into terrorism insurance arrangements. In 2003, following extensive lobbying, Pool Re – the non-nuclear property insurance arrangement - was extended to include chemical, biological and nuclear attacks and a whole range of other potential terrorist acts were covered - compare this with the Fire and Explosion cover only offered previously - whilst the insurance market retention was increased and continues to be on an upward trend. However, for reasons still unknown, Pool Re (Nuclear) remained unchanged and the coverage today on offer remains Fire and Explosion only. Meanwhile the security arrangements managed by the UK AEA Police Force were substantially overhauled.

It was not just property damage insurance that concerned insurers following the World Trade Centre attacks, it was now realised that all forms of cover left insurers exposed to multiple accumulations of exposure. Also the unique liability channelling regimes in place for nuclear sites meant that, in theory, nuclear insurers were now open to multiple simultaneous attacks on Nuclear Power Stations, with implications for not only the Property Insurance but also for the Third Party Liability Insurance, for which the Operators are strictly liable by law. If multiple attacks had occurred as a single event against the UK Nuclear sites, then insurers' solvency would be under real threat, so attention switched to managing this new, possibly unlimited exposure. Initially Insurers, both in the UK and other Paris Convention countries, made efforts to lobby the Paris Revision process through the OECD; these efforts were unsuccessful so, with little other option, the Third Party Liability Underwriters withdrew cover by giving notice to the Government and thus throwing the UK Nuclear industry into a crisis. In accordance with the Nuclear Installations Act of 1965, the Nuclear Plants require insurance to gain an Operating Licence, so they were now faced with two months in which to sort out some form of insurance, otherwise to remain within the law, they would have to shut down. The Insurers extended cover for two months to allow the Government time to work on a scheme with the insurance markets and at the eleventh hour, an Third Party Indemnity Scheme was agreed with Government; this Scheme is still in place today.

The basis of this Scheme is a new definition of terrorism, and interestingly enough this definition is very different to that used for Pool Re and it follows the definition used in the latest relevant terrorism law in the UK – The Terrorism Act of 2000 – which offers a politically controversial wider interpretation of terrorism. Insurers continue to issue to the UK Nuclear Utilities full scope Third Party Liability coverage including terrorism; however a separate premium is now charged for the terrorism risk and this premium and the exposure are then shared between Insurers and Government on an arrangement that varies each year. Initially the Insurer retention was very low but the UK Government has made it clear that it does not see itself as a long term terrorism insurer and it has insisted that the Insurance industry must gradually take this risk back off the tax-payer. Both Pool Re (Nuclear) and the Indemnity live under the cloud of a volatile Insurance market; the Insurers have made it clear that if there is another massive attack on the scale of the World Trade Centre anywhere in the world, continuing terrorism risk participation will probably end.

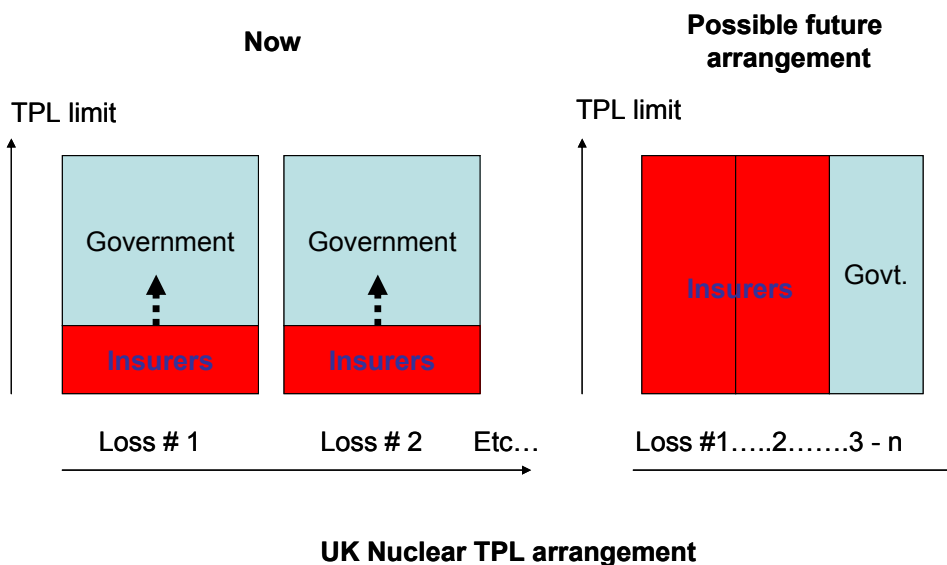
So what are the problems that we, the Insurance market, have with these arrangements at present? Well, you may have noticed that coverage between Pool Re and Pool Re (Nuclear) is now completely different. Pool Re offers much wider coverage than simple Fire and Explosion whereas Pool Re (Nuclear) remains limited to terrorism losses caused by Fire and Explosion only. To some extent this is caused by the difficulty in communicating with our Finance Department (HM Treasury), as meeting and discussing this issue with them has proved extremely difficult, but beyond that there seems little reason for the persistence of this difference. A second problem is the fact that the Third Party Indemnity is overseen by our Trade Ministry, the

Department of Trade and Industry, whereas the Property Damage arrangements are the responsibility of the HM Treasury. A third problem we have is the increasing Insurer retention levels, particularly under the Third Party Liability arrangement. In two years time the Government would like to withdraw completely from Terrorism insurance, leaving Insurers responsible for the full UK Third Party Liability limit. This might just be manageable but of course we also now have to consider the impact of the revised Paris Convention limit due to be ratified by the UK in 2006. This will increase the TPL limit to around £500m (\$875m) which represents a significant increase on the current limit of £140m (\$245m).

Nuclear Power Stations are still perceived by many Insurers and much of the general public as target risks; the physical security and difficulty of actually causing serious damage to a Nuclear Power Plant are concepts that are not well understood by the general public, or indeed many in the capital markets. To overcome some of these difficulties, we have engaged the Government in dialogue to review how the Schemes are currently structured, with the objective of making Government aware of the real concerns that Insurers have and to ensure that the Scheme can be developed in such a way that a partnership between Government and Insurers enables the new Paris Convention limits to be offered in the UK, including terrorism coverage. The attached diagram (Fig 1) represents our current thinking on how we might like to see the TPL arrangement developed. On the left the scheme is as it is now, the Government is responsible for a share of the third party limit in excess of Insurers for each loss. This share is reducing each year. At the heart of many Insurers' concerns is the prospect of multiple attacks leading to hitherto unprecedented losses from the nuclear sector and the current arrangement will do nothing to allay these concerns particularly once the insurer retention has increased. Since the 1950's nuclear insurance has been underwritten on the assumption that the losses are likely to be severe but infrequent. Multiple simultaneous terrorism attacks challenge that assumption and now opens the prospects of huge exposure to a single event. Therefore the discussion with Government is now about moving to an arrangement whereby Insurers continue to insure one, maybe two, third party limit losses arising from terrorism but the Government would still act as the Insurer of last resort by being responsible for the unquantifiable and potentially unlimited exposure of multiple attacks. This would then return Insurers to the position they were in before the World Trade Centre attacks, once again expecting a severe loss from terrorism or from other hazards on an infrequent basis but with the real knowledge that the loss was limited to be a single limit and that any multiple event would be for the account of the Government.

Further discussions are also ongoing concerning the future of Pool Re (Nuclear), with the possibility under consideration of merging the Nuclear TPL and property arrangements, or making alternative arrangements. The accumulated funds in Pool Re are now large but since 1995, with a small risk count, the Pool Re (Nuclear) funds are very limited so merging the two Pool Re's is most unlikely.

Fig. 1 UK TPL terrorism scheme



6 CONCLUSION

Discussions are continuing with Government regarding all aspects of the U.K. nuclear terrorism arrangements and it is hoped that a satisfactory resolution of the current problems we have can occur prior to the ratification of the revised Paris Convention limit in 2006. It is important that the insurance market continues to be involved in terrorism insurance as to abandon the nuclear industry is both irresponsible and reputationally damaging. However, by working in partnership with the Government, insurers should be able to achieve a reasonable divide between insurable and societal risk. This is our goal in the UK.