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* P R I O R I T Y *

SECRETARY OF STATE'S ENQUIRY

SUBJECT: INSURANCE AGAINST TERRORIST ATTACKS

APPROPRIATE ACTION TO BE LED BY: MRS MADDEN Mufax/Telecopy

(It is the responsibility of the action official to take any necessary action including redirection.)

DEADLINE: IMMEDIATE IF NECESSARY

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Additional Copies:

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Mr Fitzgerald

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CP/SOFS/10790

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PRIME MINISTER

116/132/92

INSURANCE AGAINST TERRORIST ATTACKS

Following my minute of 14 December and your agreement recorded in your Private Secretary's letter of 17 December that the Government should be prepared to act as reinsurer of last resort against terrorist attacks, we have had further discussions with individual major insurers and with the Association of British Insurers (ABI).

2 . From this has emerged a proposal which meets our objectives, and will result in the insurers continuing to provide terrorist cover without a break. Its main features are:

- (i) premiums for terrorist cover in mainland Great Britain will be pooled by the participating insurers (including Lloyd's syndicates), with the Government reinsuring the pool;
- (ii) for the first year at least, the Government will set a target for the volume of premiums we expect to see generated, assuming all insureds take the cover, and there are strong reasons for them to do so;
- (iii) if annual claims exceed the premium income in the pool, the first layer of losses will be borne by the insurers (up to 10% of premiums); in addition, the insurers will bear all the set up costs of the scheme (we estimate around 5% of premiums), plus the administration costs of a further 5-7%; and

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investment income will be disregarded. So in the first year, the maximum downside for the insurers is in fact around 20%;

- (iv) if there is a surplus, the insurers will be allowed to take a share (yet to be determined). These arrangements and those in (iii) above will ensure that the primary underwriters take a proper degree of risk, and have incentives in both directions to discipline claims;
- (v) the remaining surplus, and all investment income net of tax would then be rolled forward to enlarge the fund available to cover claims in subsequent years; if in time Government support ceased to be needed, the pool would be wound up, and the balance paid to the Government;
- (vi) if as is likely the pool is set up as a mutual insurance company, the Government will receive tax on any investment income generated, as well as corporation tax on profits allowed to the participating insurers in surplus years;
- (vii) there will be only a minimal charge for the Government reinsurance facility. Our best interests are served by maximising the year to year surplus in the fund, and eventually winding it up as a normal market resumes;
- (viii) owners and tenants of major high risk properties to maximise their security arrangements to best practice standards.

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3 My officials have indicated to the ABI that the target figure for premium income in the first full year should be about £500m although this figure should not be revealed, for obvious reasons. This will result in an average increase of 20% in property premiums, but with a very wide variation: central London offices will face increases of up to a factor of four. But the evidence available to us shows that in absolute terms, existing buildings insurance for modern office etc property is very low - typically of the order of 1% of rents. So the overall impact on business costs should be relatively small - though we can certainly expect complaints from the CBI and some other business interests.. It will of course be possible for Government to require adjustments to premium rates over time, depending on the incidence of terrorist attacks and their cost. The scheme as a whole will be subject to review and refinement after the first year.

4 I have enquired as to the general levels of profitability of the insurance companies and whether they might be expected to take a greater share of the risk. The companies have in fact been generally making losses over the last few years and I feel that officials, with advice from the consultants we appointed, have pressed the companies strongly. Subject to satisfactory resolution of the details, I believe this represents a very reasonable outcome for the Government.

5 It will take perhaps a couple of months or so to settle all the detailed arrangements and to get the new institutional arrangements up and running though the Government's exposure will begin on 1 January 1993 (25 December in respect of policies covering the Corporation of London). The ABI are however prepared to extend cover on the basis of a public statement of intent from Government, plus a

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private exchange of correspondence with my officials, which they will clear in advance with the Treasury.

6 Legislation will be required but the bill should be short and largely uncontentious. I am advised that early introduction will be needed both because of the nature of the issue and for reasons of financial propriety.

7 Subject to any comments you and colleagues may have on the draft press announcement (copy attached), I propose to release this on Monday 21 December. Parliament will need to be informed after the Recess, and meanwhile I shall inform the PAC and TISC of the prospective contingent liability in the usual way.

8 I am sending copies of this minute to Douglas Hurd, Norman Lamont, Kenneth Clarke, John MacGregor, Michael Howard, Peter Lilley, Paddy Mayhew, John Wakeham, Tony Newton, Richard Ryder, Robin Leigh Pemberton and Sir Robin Butler.

M H

18 December 1992

DEPARTMENT OF TRADE AND INDUSTRY

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:DATE:

MICHAEL HESELTINE ANNOUNCEMENT ON INSURANCE COVER FOR TERRORISM

Michael Heseltine, President of the Board of Trade, today announced the Government has decided in principle to act as reinsurer of last resort for terrorist attacks against mainland GB non-domestic property and related risks from the end of this year.

Mr Heseltine said this decision had been taken in the light of recent developments and after discussions between the insurance industry and his Department.

"In recent months it has become increasingly difficult for insurers operating in the UK to obtain the reinsurance protection they need so they can continue to offer terrorism cover in Great Britain for new policies and renewals from the end of this year."

Mr Heseltine said that the basis on which the Government will be prepared to make reinsurance facilities available will be made known at a later date after further discussions with the insurance industry.

"It is the Government's objective that its involvement should be of limited duration and should cause the minimum interference necessary with the working of the market. Costs to Government should also be kept to a minimum over a period of time.

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"In the light of this decision the Government expects that owners and tenants of industrial and commercial property should continue to be able to obtain cover against terrorist attacks. The price of such cover will, however, be adjusted to reflect the changes in the risk in the usual way."

Mr Heseltine emphasised the announcement does not mean that the Government will pay compensation to businesses who are uninsured for terrorist risks.

He added that legislation to implement the arrangement would be laid before Parliament in due course.

ENDS

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cc Mr Munn
Mr R. Munn
ASIP/93
8/12

6/11/2001/92

8 December 1992

Mr G. G. G. G.
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29/12/92

14-12
Mr. Fitzsimons

James Michael

TERRORIST ATTACKS - INSURANCE

Thank you for sending me a copy of your letter to the Prime Minister.

I agree that the decision by the Association of British Insurers to withdraw cover for terrorist action against industrial and commercial property is extremely worrying. The potential damage is not solely to the property market and major firms. If the IRA come to believe that their economic warfare is succeeding the consequences are much more far reaching.

It is not surprising that the Northern Ireland scheme is the option which the insurers favour but our situation is very different and I agree that it is essential to look at other options for tackling the problem in Great Britain. Whatever solution is adopted I am clear that it would be a grave mistake to attempt any change to the longstanding arrangements which apply here in the Province.

My officials stand ready to help with information on the workings of our scheme.

I am copying this letter to the Prime Minister, Douglas Hurd, Norman Lamont, Kenneth Clarke, John MacGregor, Michael Howard, Peter Lilley, Robin Leigh Pemberton and Sir Robin Butler.

hcc: PS/SOFS(B+L)
PS/Mr Nokes (DFP, B+L)
PS/PSO(B+L)
PS/Mr Fell
Mr Ledue
Mr Lyon
Mr Semple
Mr Blackwell
Mr Steele
Mr Cooke
Mrs Madden

James Michael

HS/SOFS/11816

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