



Australian Government

Australian Reinsurance Pool Corporation

# **Effective Terrorism Exclusions**



## Terrorism Exclusions

Section 8 of the *Terrorism Insurance Act 2003* (Cth) (**TI Act**) provides that terrorism exclusion clauses in eligible insurance contracts have no effect in relation to loss or liability arising from a declared terrorist incident (**DTI**). Section 8(2) of the TI Act states:

"For the purpose of sub-section (1), "**terrorism exclusion**" means an exclusion or exception (however described) for:

- (a) acts that are described using the word "terrorism" or "terrorist" or words of similar effect; or
- (b) other acts (however described) that are substantially similar to terrorist acts as defined in section 5."

The effect of rendering a terrorism exclusion clause ineffective is that payouts available to a policyholder under an eligible insurance contract, for eligible terrorism losses, will depend on the terms and conditions of the underlying coverage in the eligible insurance contract, except for the fact that the terrorism exclusion is treated as if it did not exist.

However, eligible terrorism loss does not include loss or liability arising from the hazardous properties (including radioactive, toxic or explosive properties) of nuclear fuel, nuclear material or nuclear waste (**the Nuclear Carve Out**).

It is very important for the operation of the TI Act that there be no ambiguity as to whether a contract of insurance contains a terrorism exclusion within the meaning of section 8(2) or how it operates. This is because:

- if a contract of insurance is covered by section 7(1) of the TI Act but does not contain a terrorism exclusion, the contract is not an eligible insurance contract for the purposes of the TIA by virtue of section 7(2)(b) of the TI Act and Item 37 of Schedule 2 of the TI Regulations;
- on the other hand, if a contract of insurance is an eligible insurance contract, a terrorism exclusion contained in that contract is of no effect in relation to a loss or



liability to the extent to which the loss or liability is an eligible terrorism loss (section 8(1)).

The ARPC has seen many terrorism exclusions and makes the following observations for the consideration of its reinsureds.

*'Embedded' commentary concerning the operation of the TI Act*

Many policies contain a clearly worded terrorism exclusion, which then goes on to include a sentence in words to the following effect:

"This terrorism exclusion will not operate in the event that the Treasurer declares an act to be a declared terrorist incident under the Terrorism Insurance Act." (**Sample I**);

OR

"[This policy excludes cover for any act of terrorism] except to the extent provided under *Terrorism Insurance Act 2003, (Cth)*" (**Sample II**).

In the case of Sample I, such a sentence is a 'commentary' or explanation as to how the TI Act will affect the operation of the exclusion. Such commentary is not necessary because section 8(1) will automatically render a terrorism exclusion inoperative, provided that the requirements of the section are met. There is no need for any language to be included in the policy words to achieve the outcome provided for by section 8(1).

In the case of Sample II, the additional words do not say anything particularly meaningful and, again, are unnecessary.

The ARPC suggests that if any reference to or commentary on the operation of the TI Act is to be provided, it should be set out in the product disclosure statement and not in the policy wording.



### *Ambiguity and unintended consequences*

Some exclusion clauses purport to exclude losses or liabilities arising from an act of terrorism and then go on to say words to the following effect:

"... in the event that the Treasurer declares an act to be a declared terrorist incident under the Terrorism Insurance Act we will not apply this exclusion unless the act of terrorism was directly or indirectly caused by, contributed to by, resulting from or arising out of or in connection with biological, chemical, radioactive, or nuclear pollution or contamination or explosion." (**Sample III**)

First, if the requirements of section 8(1) are met, it is not correct to say "we will not apply". The terrorism exclusion will automatically be rendered inoperative in relation to a loss or liability to the extent to which the loss or liability is an eligible terrorism loss.

Second, the use of the word "unless" gives rise to several issues that should be carefully considered so as to eliminate any ambiguity or confusion:

- the word "unless" suggests that cover will be provided in certain limited circumstances. That may or may not be the intention of the insurer;
- assuming that the requirements of section 8(1) are met, under Sample III, a loss arising from an act of terrorism that was directly or indirectly caused by, contributed to by, resulting from or arising out of or in connection with:
  - Nuclear and radioactive pollution or contamination or explosion IS NOT an eligible terrorism loss because of the Nuclear Carve Out. However, it is unlikely that the insurer intends to cover such a loss;
  - The TI Act and Regulations do not exclude cover for biological and chemical pollution or contamination or explosion. In addition, the TI Act and Regulations do not consider biological and chemical exclusion clauses to be terrorism exclusion clauses. While an eligible policy may give cover for losses from biological and chemical pollution or contamination or explosion,



individual policy exclusions for pollution or contamination may limit the cover to a policy holder regardless of Section 8(1).

Third, it is usual for certain types of contracts of insurance to include standard chemical, biological, radiological or nuclear exclusions which are not terrorism exclusions and which have been in use long before the introduction of exclusions for acts of terrorism. Such exclusions should not be "mixed up" with or imported into terrorism exclusions.

**A terrorism sub limit: What effect does this have?**

A terrorism sub-limit is a terrorism exclusion within the meaning of section 8(2) of the TI Act.

The effect of the imposition of the sub-limit is that the contract will cover an eligible terrorism loss up to the amount of the sub-limit of liability but not beyond. The policy excludes cover for that part of an eligible terrorism loss that exceeds the sub-limit.

A terrorism sub-limit operates in a way which falls within the ordinary meaning of the words used in section 8(2) of the Act, being: "an exclusion or an exception (however described) for acts that are described using the word "terrorism" or "terrorist" or words of similar effect".

The sub-limit operates to exclude the amount of any loss, damage or liability arising from a terrorist act which exceeds the sub-limit and in that sense it operates as a exclusion in the relevant sense. Also a sub-limit with respect to terrorism constitutes an exception for terrorism because it has the effect that the total sum insured is not available to cover the amount of any loss, damage or liability arising from a terrorist act.

The consequence is that pursuant to section 8(1) the terrorism sub-limit has no effect in relation to a loss or liability to the extent to which the loss or liability is an eligible terrorism loss.